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Politics this week

Jan 13th 2005
From The Economist print edition

Abbas wins

EPA

Mahmoud Abbas (also known as Abu Mazen), a long-serving lieutenant of the late Yasser Arafat, was elected president of the **Palestinian Authority**, winning 62% of votes cast, against 20% won by his closest rival, Mustafa Barghouti, who campaigned on an anti-corruption ticket. Seven out of ten registered voters turned out, but that was fewer than half of all eligible voters.

See article

Ariel Sharon, **Israel's** prime minister, congratulated Mr Abbas; the pair may meet next week. But after a lull during the election, violence resumed. Israel killed two members of Islamic Jihad in a West Bank raid. In Gaza, Palestinians continued their attacks on Israeli settlements.

Election campaigning began in earnest in those parts of **Iraq** where the insurgency allowed it to. The interim prime minister, Iyad Allawi, who heads a secular-minded Shia list, accused the main Islamist-inclined list, which was drawn up with the help of Grand Ayatollah Ali al-Sistani, of exploiting religion in politics. He also admitted that the election, due on January 30th, could not be held in some “pockets” of the country dominated by the insurgents.

See article

The United States confirmed that it had abandoned its search for Iraq's **weapons of mass destruction**.

A new **Sudanese** government was poised to take shape after the signing of a peace deal with the main separatist movement in the country's south, enabling John Garang, the southerners' leader, to join a power-sharing government.

In a plea bargain, **Sir Mark Thatcher**, son of Margaret, admitted to negligence in having inadvertently helped a coup plot in Equatorial Guinea. He said he did not know a helicopter in which he invested would be used in a coup.

After the wave

The Paris Club of the world's biggest creditor nations offered a debt moratorium to countries affected by last month's **tsunami**. Indonesia, Sri Lanka and the Seychelles have taken up the offer.

See article

Tribesmen launched attacks on **Pakistan's** largest natural-gas field, in Baluchistan. Meanwhile, an air-force officer accused of trying to assassinate President Pervez Musharraf escaped from jail.

China's government announced a crack-down on illegal gambling.

Jail time

In a 5-4 split decision, America's Supreme Court ruled that federal judges were no longer bound by controversial **sentencing guidelines** established by Congress in the mid-1980s, which permitted an increase in prison time on the basis of post-trial findings.

See article

Michael Chertoff, a federal appeals-court judge, was nominated as the next secretary for homeland security.

See article

Christine Gregoire was inaugurated as **Washington state's new governor**. The Democrat won a second recount by 129 votes. The Republicans, whose candidate won the first two ballot counts by equally tiny margins, are challenging the election.

See article

George Bush named two retired senators, Connie Mack and John Breaux, to lead a bipartisan advisory panel on **tax reform**. He also promised to provide “political cover” to congressmen nervous about supporting his plan to reform **Social Security**.

See article

Following an independent review into a misleading story on Mr Bush's **National Guard** service, broadcast during last year's presidential campaign, CBS News sacked three executives and a producer. Dan Rather, the veteran anchor who is retiring in March, was criticised for his “over-enthusiasm” for the story.

Arnold Schwarzenegger unveiled a $112 billion budget for **California**. Cuts were made to transport and health care, but there were no new taxes. The plan now goes to the legislature where it needs a two-thirds majority to pass.

See article

Edgar Ray Killen was charged with the infamous 1964 murder of three **civil-rights workers** near Philadelphia, Mississippi. Mr Killen, an elderly preacher who has pleaded not guilty, is the first person in the case to face trial on specific murder charges.

Down on the farm

EPA

Venezuela's president, Hugo Chávez, set up a committee to speed

the distribution of “unproductive” farms to peasant co-operatives. Earlier, a state governor backed by troops served an “intervention order” on a British-owned farm.

See article

In **Canada**, a cow in Alberta tested positive for **BSE** (“mad cow” disease), the second case in a fortnight.

More trouble for **Peru's** president, Alejandro Toledo: the interior minister resigned over his failure to prevent a brief armed uprising on New Year's Day, and the president's sister was placed under house arrest on charges of falsifying signatures for his party's legal registration in 1998.

In **Bolivia**, demonstrators shut down two main cities, Santa Cruz and El Alto, in protest at fuel-price rises.

Argentina's government prepared to launch a take-it-or-leave-it offer to holders of bonds worth $81 billion on which it defaulted in 2001. The offer involves a writedown of some 70% of its original value.

See article

Sore loser

Ukraine's central election commission declared that Victor Yushchenko had won the country's disputed presidential election. But his inauguration was further delayed by more court appeals by his opponent, Victor Yanukovich.

The **Russian economy minister**, German Gref, said that both Rosneft and Yuganskneftegaz, the oil-producing unit of Yukos that was recently bought by Rosneft, should be privatised, on the ground that most state companies were “ineffective”.

Tony Blair blamed the **Irish Republican Army** for one of Britain's biggest bank robberies, in which £26.5m ($50m) was stolen by an armed gang late last year. Attempts to bring the IRA's political wing, Sinn Fein, into government in Northern Ireland have been stymied by the crime.

The disputed presidential election in **Abkhazia**, a breakaway statelet in Georgia that is backed by Russia, was rerun, with the winner and loser of the October vote this time fighting on the same side.

Italy became the latest country to ban smoking in most public places; the ban took effect on January 10th.

AP

Business this week

Jan 13th 2005
From The Economist print edition

Airbus tops Boeing

Airbus pipped **Boeing** in commercial aircraft deliveries for the second year in a row, supplying 320 aeroplanes in 2004; Boeing said it delivered 285. Meanwhile, America and the European Union agreed to start negotiations on eliminating the subsidies given to both aircraft manufacturers, in the hope of averting damaging litigation at the World Trade Organisation.

See article

Amadeus, which supplies travel-reservation systems to large airlines, was sold to Cinven and BC Partners, two private-equity firms. The Spanish-based company was valued at *euro*4.3 billion ($5.7 billion), making its sale one of the largest private-equity deals in Europe.

Alltel said it would buy Western Wireless for $6 billion, in a deal which will create America's fifth-largest wireless provider. Meanwhile, the nation's largest cable-TV firm, **Comcast**, said it would start an internet-based telephone service in selected markets by the end of this year.

Paying for it

Nortel Networks released restated results from 2003, which reduced reported profits by some $300m. The Canadian telecom-equipment maker blamed several former executives for using “inappropriate” accounting methods to inflate profits, and thus their own bonuses. A dozen senior executives, who had not been directly involved, will nevertheless return $8.6m in bonuses over the next three years. Five board directors will also step down.

It emerged that ten former directors of **Enron** will pay $13m from personal funds as part of a settlement reached in a class-action lawsuit by shareholders enraged by the firm's sudden collapse in 2001. Ten ex-directors of **WorldCom,** a telecoms firm which also went bankrupt**,** recently agreed to pay $18m from their own pockets as part of a settlement in a similar lawsuit by that firm's shareholders.

See article

Rupert Murdoch's **News Corporation** sought full control of Fox Entertainment, its American television and film-studio affiliate, by offering a stock swap to shareholders worth some $6 billion. The conglomerate, which already holds 82% of Fox's equity, wants to simplify its holdings.

Small is beautiful

Apple unveiled a tiny no-frills version of its bestselling iPod music player that will retail at $99. The company recorded frenzied sales of 4.5m iPods in the Christmas quarter. Net income rose by 368% to $295m for the three months ending in December compared with a year earlier. Apple also unveiled a new mini-Macintosh computer (the size of a large book, but with no monitor, keyboard or mouse) that will sell for $499.

See article

Intel recorded a 13.5% increase in its revenue during 2004, to $34.2 billion. However, all was not well in Silicon Valley. **Advanced Micro Devices**, released a profit warning because of a price war in the flash-memory market.

The world's largest producer of aluminium, **Alcoa**, said that net income fell by 9% to $268m year-on-year for the last quarter, ending in December, despite a 12% increase in revenue. Aluminium prices reached a nine-year high in 2004, but the company said it had been hit by higher labour and energy costs.

Bristol-Myers Squibb announced plans to sell its North American consumer medicines, representing 1-2% of its roughly $22 billion worldwide sales. The company, which has lost the patents on some of its key drugs, said it will hold on to its consumer medicine businesses in the rest of the world, including Europe and Japan.

King Pharmaceuticals said it needed to restate its financial results for 2002, 2003 and the first half of 2004. Mylan Laboratories, one of the world's largest makers of generic drugs, claimed it would now need to renegotiate the price of a planned merger with the company.

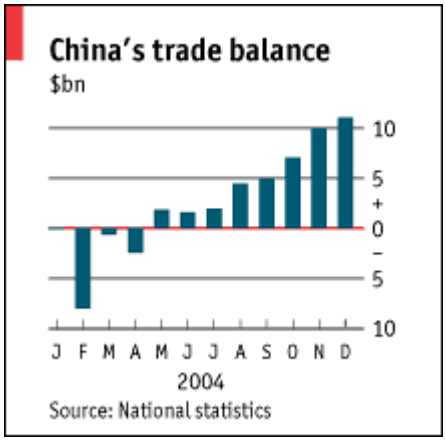
Standard Chartered agreed to pay 3.4 trillion won ($3.3 billion) for **Korea First Bank**. The British bank beat rival HSBC to close the deal with Newbridge Capital, an American investment group, which owns 49% of the South Korean bank.

Israel nominated **Stanley Fischer**, a vice-chairman at Citigroup, to be the governor of its central bank, the Bank of Israel. Mr Fischer is a notable economist and former deputy-head of the IMF.

See article

The dragon keeps roaring

China recorded its largest monthly **trade surplus**, $11.1 billion in December, for nearly a decade. The total surplus for 2004 was $32 billion. Exports amounted to $593.4 billion. George Bush's outgoing commerce secretary, Don Evans, arrived in Beijing and promptly insisted that China must “forcefully do more” to ease its trade surplus with America.



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George Bush

Four more years

Jan 13th 2005
From The Economist print edition

George Bush has a radical vision; this time he must follow it through

Getty Images

NEXT week, a familiar ceremony will take place in Washington, DC: a crowded Mall, a huddle of grey overcoats, the oath of office, idealistic promises fluttering through the frosty air—while, off-stage, those bold words are undermined by the first compromises between the new administration and congressional power-brokers. Inaugurations represent both the summit of American politics and the moment when every presidency starts to lose its magic. With second-term presidencies, the collision with reality is often rapid. Congress's mind is already half on the mid-term elections in two years' time—and after that the president is a lame duck.

George Bush deserves credit for his determination to buck this trend. In an era when most politicians pursue office for the office's sake, America—and by extension the world—is led by a man who genuinely wants to change things. After a momentous first term, which saw, among other things, one of the largest tax cuts in history, the biggest shake up of American schools for a generation, a foreign-policy revolution, the transformation of the armed forces, two wars and the re-consolidation of executive power, Mr Bush wants more. Much more.

This time, the main focus of change is supposed to be at home (see article). The noisiest battle probably awaits a vacancy on the Supreme Court: with several justices ailing, Mr Bush has the chance to “conservatise” the nation's highest court. But Mr Bush is also embarking on a Republican New Deal: he wants to privatise a part of the pensions system (and ultimately part of the health-care system too), simplify the tax system and create what he calls an “ownership society”. Oh, and he also has courageous ideas to reform America's much-abused tort system and to deal with illegal immigration.

As if this were not enough, there is foreign policy to consider. It is not just a question of the elections in Iraq, essential though it is for those to go ahead on time (see article); throughout the campaign, Mr Bush never wavered from his commitment to spread democracy throughout the Middle East. He will spend much of this year trying to bully the new Palestinian leader, Mahmoud Abbas, and Israel's Ariel Sharon towards peace. There are fences to build with Europe, which he is visiting in February; nuclear difficulties with Iran and North Korea; renewed concerns about both Russia and China; the possibility of reform at the United Nations. And that is before you consider the unexpected, like September 11th 2001.

Three questions spring from this list: is Mr Bush trying to do the right things? Is he going about them the right way? And is he trying to do too much? In general, this newspaper shares most of Mr Bush's more radical goals. (One obvious exception would be any attempt to create a theocratic Supreme Court—which still seems unlikely.) When it comes to the most revolutionary part of his domestic programme, we have long urged some form of pensions reform before the huge baby-boom generation begins to retire. Overseas, too, the administration has principle on its side in most of its squabbles with Europe—for instance, over the paramount need to prevent Iran acquiring nuclear weapons or the necessity of continuing the arms embargo on China.

Our doubts with Mr Bush come with his means, not his aims. The president has a radical's talent for spotting the big opportunity and grasping it rapidly. But too often, the follow-through has been shambolic and unnecessarily risky. For such a determined revolutionary, Mr Bush has been oddly indulgent of failure among his staff. And for a man so committed to changing the world, he has often been curiously uncommitted to winning over the hearts and minds of doubters, especially abroad.

Thus, in his first term, the White House pushed through tax cuts, but did nothing to rein in spending; the resulting budget deficit makes both Social-Security and tax reform more difficult. A good education bill has teething problems that Mr Bush has ignored. The admirable ideal of countering terror with democracy has been undermined by America's civil-liberties record—and by Abu Ghraib and Guantánamo Bay. With Iraq, Mr Bush fought a war of choice (a good one in our view), but that cause, not to mention peoples' lives, has been imperilled by incompetence. Mr Bush recently awarded the Presidential Medal of Freedom—America's highest civilian honour—to the man who said that Iraq had weapons of mass destruction and another man responsible for disbanding the Iraqi army. Heaven knows what honour he has reserved for Donald Rumsfeld, the apparently unsackable defence secretary.

Hard choices ahead

Mr Bush has given signs that he wants to tighten up his act. He seems bent on taking a tougher line on congressional pork (vetoing something soon would help). He has replaced much of his cabinet. Putting Condoleezza Rice in charge of the State Department should bring more co-ordination to foreign policy. Less welcome is the decision to promote Alberto Gonzales, the White House counsel who commissioned an infamous memo justifying torture, to attorney-general.

However, even with fresh personnel and greater discipline, Mr Bush faces choices. More tax cuts are less important than tax reform, and that has already been delayed. The main priority should be Social Security—crucial because it opens the door to reforming other entitlement programmes. Pensions reform is complicated, since the immediate transition costs can be big and the true gain may not be seen for generations. To stick, it also needs support from doubting Democrats. Concentrating on getting that and tort reform through (and doing them well) would be a powerful domestic legacy.

From a foreign-policy viewpoint, the danger could well be attempting too little, not too much. As

domestic policy sucks in Mr Bush, he may pull in his horns overseas. The first test may come after the Iraqi election: the temptation to leave before a new government has established itself, declaring that America has delivered democracy, will be big, especially if American troops are still dying at the present rate. That temptation should be firmly resisted. A radical who runs away from his own revolution is merely a vandal.

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South Korea and human rights

Silence emboldens

Jan 13th 2005
From The Economist print edition

A shameful policy and nothing to show for it

Reuters

Get article background

IT ISN'T easy living next door to hard-faced North Korea. Even before it took to brandishing its “nuclear deterrent” at all-comers, South Koreans were living in the sights of thousands of artillery guns and missiles that could rain all-too conventional destruction on their cities. In hopes of better relations, in recent years South Korean governments have promoted engagement over confrontation with the prickly North. Demands for “reciprocity”—better behaviour—from North Korea have also been set aside. Such no-strings engagement has its costs. Right now it is making life that bit harder for vulnerable North Koreans hoping to flee political repression at home and make their way via China and places like Cambodia, Laos, Mongolia, Myanmar, Vietnam and Russia to seek asylum in the South.

The NGOs and missionaries working along the Chinese border with North Korea are used to having no support from the South Korean government, which perennially fears that if the refugee trickle (fewer than 2,000 North Koreans reached South Korea last year, up from a handful in the early 1990s) becomes a flood, North Korea may lash out—or collapse and become a costly burden. Shamefully, South Korea also keeps quiet about close to 500 of its citizens thought to have been abducted over the years by North Korean agents.

Now South Korea's unification minister has in effect said sorry to North Korea for the embarrassment caused last July when 468 refugees who had fetched up in Vietnam were flown to the South: there will be no more such large-scale rescues, he said. There is talk too of making travel harder for those (admittedly a few of them profiteers, but most of them not) who help North Koreans escape.

The refugees already have a hard time of it. At home, those deemed hostile to the regime (or not supportive enough) receive less food. Up to 200,000 political prisoners are held in labour camps; their families down to three generations are often treated similarly harshly. A few manage to flee over the border into China. But despite having signed international conventions governing protection of refugees, China hunts them out, brands them “criminals” and dumps them back in North Korea where punishment awaits.

Bad form, but bad policy too

South Korea generously takes in those North Koreans who do make it—around 5,000 so far. But there are good reasons for holding North Korea, and China, more accountable over human-rights abuses and the mistreatment of refugees. One is that the scandal over such abuses is set to grow. The UN last year appointed a special rapporteur to look at human rights in North Korea. America is soon to appoint a special envoy too. As more stories of the human-rights horrors in the North become known, including through the South's increasingly feisty press and parliament, the South Korean government risks seeing its own reputation tarnished by keeping mum.

Besides, refusing to take up the issue has won no concessions from North Korea. On the contrary, engagement without even the strings of human decency attached serves only to persuade the North's Kim Jong-Il that he can get away with anything, and that he has South Korea's government in his pocket, along with all the food, fertiliser, coal and other goodies it offers. South Korea's government, meanwhile, gets the worst of all worlds: the appearance of acquiescing in the ill-treatment of fellow Koreans, and nothing to show for it.

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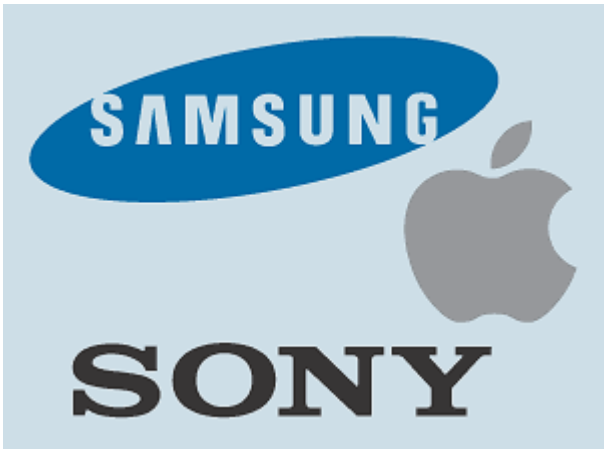
Consumer electronics

Brand new

Jan 13th 2005
From The Economist print edition

Samsung's success shows the value of brands even in a world of new digital gadgets



AT LAST weekend's consumer-electronics show in Las Vegas, digital convergence arrived with a vengeance. Among the avalanche of new products were lots of mobile phones. Those fitted with digital cameras and camcorders are hardly new, but they now take even better pictures. Others can be used to play three-dimensional video games, download movies, watch live TV (and record it during an incoming call), operate home-security systems and listen to music files downloaded from the internet. More marvels are on the way. In the midst of this frenzy of new and unfamiliar gizmos, product features would seem to count for everything. But companies in the hypercompetitive electronics industry are discovering something unexpected, and curious: brands matter almost as much as dazzling new technology.

One of the clearest demonstrations of this is South Korea's Samsung Electronics, which made a big splash this year in Las Vegas. Samsung was once best known for making things like cheap microwave ovens. In the past few years it has transformed itself into one of the “coolest” brands around, and is successfully selling stylish flat-screen TVs, digital cameras and mobile phones. After a record-breaking year, it is poised to overtake Motorola as the world's second-biggest maker of mobile phones. And it is snapping at the heels of Japan's Sony for leadership in the consumer-electronics business (see article).

This would have seemed inconceivable a decade ago. But Samsung has proved that a combination of clever brand-building and well-designed, innovative products can work miracles. In such a competitive market, a brand without good products will quickly fade. But the real surprise is that the opposite is also true. The market is crowded with firms with a few snazzy products, but weak brands. To thrive and grow on the scale Samsung has achieved requires a strong brand, as well as innovative products.

Years ago, when products did not change much and companies largely stuck to their knitting, American and European consumers faithfully bought cameras from Kodak, televisions from RCA and radios from Bush, because those brands represented a guarantee of quality. Then the Japanese got better at what they made. Now the South Koreans are doing the same. And yet with many American and European electronics companies making their gadgets in the same places, even sometimes the same factories, as their Asian competitors, the geography of production has become less important. Many consumers are now looking for a guide through a bewildering array of choices. A strong brand offers such guidance.

Apple bites

Moreover, digital convergence allows a company with a strong brand in one area to move more easily into another. Hence Sony invented portable music with the Walkman, but was slow to come up with a digital replacement. It lost its lead—not to another consumer-electronics maker, but to Apple, the Californian computer firm which has had a huge hit with its iPod. Now that the iPod has introduced the Apple brand to lots more people—including many who use PCs running Microsoft's Windows operating system—Apple has announced new low-cost versions of both its iPod and its Macintosh computers in an attempt to exploit its brand and reach further beyond its computing niche (see article).

In addition to the traditional promise of quality, a strong brand also offers consumers at least some hope that complex new products made by the same company will work together. Firms ignore this hope at their peril. This is one reason why Sony, Apple and Samsung have all opened “brand showrooms” where customers are encouraged to try out their wares. Although many shoppers now use the internet to make price and product comparisons, many still also want to touch the real thing before they part with their cash. In addition, the showrooms help people understand how these new products work. Some of them, you may have noticed, come with instruction books bigger than the product.

Indeed Philips, one of Europe's oldest electronics suppliers, is trying to regain market share lost to Asian rivals by re-branding itself around the idea of “sense and simplicity”, promising that everything it produces, from heart defibrillators to coffee machines, will be both highly advanced and very straightforward to use. That is a tall order. But if Philips can fulfil this promise, it could prove a winning branding strategy. And as Philips has already discovered to its cost, even when it comes to high-tech wizardry, brands still matter. Just ask Samsung.

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Corporate directors

Stick 'em up

Jan 13th 2005
From The Economist print edition

Should board directors be forced to dig into their own pockets to settle shareholder lawsuits?

WITH all the woes in the world, it seems perverse to feel sorry for the board directors of big public companies. But in the past few years, believe it or not, directors have felt rather sorry for themselves. Many have been blamed, at least in part, for a wave of corporate scandals on both sides of the Atlantic, their reputations tarnished by the crimes of others. In the wake of those scandals, new laws have been passed, loading yet more responsibilities on to their shoulders. Appointment to a corporate board once seemed an undemanding honour, the ideal adornment to an already successful career. Today it is beginning to look more like a job from hell.

The final blow to the idea of a director's seat as a flattering corporate bauble seems to have been delivered this month with the announcements that ten former directors from each of two big firms, WorldCom and Enron, have agreed to cough up a collective $18m and $13m respectively of their own money to help settle lawsuits launched by enraged shareholders against them and their firms. This is almost unprecedented. Directors have often been sued by shareholders, and former directors of Walt Disney, Hollinger International, a newspaper group, and Britain's Equitable Life, a life assurer, are also currently the targets of high-profile lawsuits. But it is not clear yet whether any of these directors will ever have to pay a penny. Many such lawsuits fail. The usual outcome of those that succeed is for directors' legal costs and damages to be paid by directors' liability insurance (see article). So the settlements agreed by the WorldCom and Enron directors, coming so close together, sent a thrill of fear through boardrooms.

Ouch!

Let them tremble, might be many people's first reaction. But this would be a mistake.

Independent directors play a vital role in shareholder capitalism, representing the interests of a usually disparate crowd of shareholders as well as providing a regular outside check on managers. Somewhat like British monarchs, directors have the right to be consulted, the right to encourage and the right to warn. But they do not usually exercise control. When their advice is ignored, or a firm runs into difficulties—whether through the fault of managers or merely as a result of routine misfortunes—serving as a director can feel like a thankless task. If, on top of this, directors now run the risk of losing large sums of their own money as well, recruiting good people to be directors will be a lot more difficult.

Fortunately, there are reasons to believe that the WorldCom and Enron cases may not lead to that bad outcome. For one thing, they are among the most egregious examples in corporate history of directors failing to do their job, and so should not establish widely followed precedents. WorldCom, a telecoms firm since renamed MCI, became the biggest bankruptcy of all time after it was discovered that it had falsely inflated its income by tens of billions, apparently with few questions from its incurious directors. Enron also collapsed spectacularly after accounting fiddles that seemed to have raised barely a peep from outside directors.

Most directors never approach these levels of negligence. Even in these two cases, the sums that directors will pay are a tiny fraction of the overall amounts sought, and are meant to penalise, not to ruin them. The WorldCom directors have agreed to pay 20% of their net worth, not counting their primary residences and retirement accounts. The Enron directors, some of whom gained by selling Enron shares before the firm collapsed, are handing over some of their trading profits.

The intent of the investing institutions which have led the lawsuits in both cases seems to be to chastise, in the hope of encouraging other directors to greater vigilance. In these two extreme instances, making directors pay some of their own money seems justified. But, it has to be admitted, striking the right balance is difficult. If a flood of lawsuits now target directors' personal assets, the supply of good directors is bound to dry up, and that would harm shareholders themselves most of all. Directors don't deserve to be pitied, and they should be held accountable. Yet they are, after all, usually watchdogs, not culprits themselves. When they fail as watchdogs, they should be shamed, but not turned into scapegoats.

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Iraq's general election

Messy but necessary

Jan 13th 2005
From The Economist print edition

Delaying Iraq's coming election would do more harm than good

Reuters

THOUGH Iraq's future is as clear as a desert sandstorm, three things stand out. First, a general election will take place, as heralded, on January 30th. Second, a large portion—perhaps a big majority—of the country's Sunni Arabs, who ran the place for the 80-odd years of its existence as a state and make up a fifth of its people, will be unable or unwilling to vote, so the election result will be widely derided as flawed or even worthless. Third, it is plain that delaying the election's date, as many reasonable Iraqis have suggested, would not make matters better and might well make them worse.

The poll must go ahead—on time. Most Iraqis, especially the long-oppressed Shias (who make up nearly three-fifths of the populace) and the defiant Kurds (about a fifth), fervently desire it. And though, in the run-up to the event, the battered Iraqis are sure to witness ever more bloodshed and horror, as the insurgents do their damnedest to intimidate those wanting to vote, it will still be a cherished first time in living memory that most Iraqis will have been offered—in however messy a manner—a choice in who should govern them.

The election's flaws are patent. For one thing, the planned method of voting is unsatisfactory (see article). Iraqis are to choose between broad national lists, many embracing a bewildering array of diverse parties, not for individuals or smaller constituencies. Many of the candidates' names on those lists have still not been published; voters will have little chance to scrutinise their records or see them debating. Yet, with the highly regrettable exception of Sunni Arabs in the triangle west of Baghdad and around it, most Iraqis should still—barring an unexpected upsurge of violence in the Kurdish and Shia parts of the country—be able to have a rough but fair choice. The two main Arab lists, one seemingly favoured by Iraq's leading clergyman, Grand Ayatollah Ali al-Sistani, the other led by a secular-minded Shia, Iyad Allawi, the interim prime minister, will indicate the sort

of Iraq the majority of Shias would like. The Kurds' choice will be plainer, for there are few would-be election-wreckers in their neck of the country. The poll will also measure, more or less, the support for several long-established movements, such as the Communists and monarchists, suppressed under Saddam Hussein.

Various ideas to bring more Sunnis on board have been aired. One is to stagger the elections so that, in the four most violent of Iraq's 18 provinces, they can be held later. Another is to reserve more seats for Sunnis in the new assembly. But no legal provision for such adjustments appears to exist. In any case, the emerging transitional national assembly should represent the will of most of the people, and will endorse a government far more legitimate than the present American-sponsored, UN-endorsed one. Moreover, whatever government emerges must include a good number of Sunni Arabs. Not enough, of course, to deter the insurgents, whose numbers may be rising. But if the new assembly can start to draft a constitution and enact laws that suggest it is not an American pawn, some of those who opposed the previous foreigner-appointed government as stooges may—so it is hoped—pause.

Among other crucial issues, the new government will have more power to decide how to fight the insurgents. It is conceivable but unlikely that it will decide that the Americans are a bigger part of the problem than the solution, and instruct them to leave. Once a constitution is written, and endorsed in a referendum in the autumn of this year (though a six-month delay has been provided for), another election, with luck at the year's end, should produce a still more representative assembly and a more obviously legitimate government.

A very long grind

It would be naive to expect a dramatic turning-point. The insurgents remain obdurate. It is crucial, on this score, that Iraq's own puny pro-government forces are beefed up fast. Provided the new government agrees, the Americans and their remaining allies (this week Ukraine became the latest country to say that its troops would shortly leave) must resist the temptation to quit before the new government has been given every chance to establish itself. If anything, there may be a need for more outside military help. Even if the election goes as well as can be expected—with, say, over half of Iraqis daring to vote—and even if the new government shows unusual courage, skill and unity, it will be a very long grind. The case for toppling Mr Hussein was debatable. But at this point an American rush for the exit would be both a humiliation and a disgrace. For the Iraqis themselves, there can be no going back.

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Letters

Jan 13th 2005
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

How to aid Asia

SIR – Initially, observers were hopeful that, at least in the short term, the conflicts in Aceh, Indonesia, and Sri Lanka would be suspended in the wake of the tsunami disaster ("Helping the survivors", January 8th). Three weeks on, and despite early signs of co-operation, this optimism has been largely shattered by the escalating war of words in both regions. In Aceh, there have been reports of renewed violence, and rebels and the military have levelled accusations against each other of exploiting the situation for their own purpose. In Sri Lanka, the situation is not much better. It appeared the country had returned to its own kind of normality when Kofi Annan was refused permission to visit rebel-held areas.

What can the international community do? One positive impact could result from imposing some kind of conditionality on the distribution of aid. The sheer size of the donations that some countries in the West have made may give them some leverage to pressure the conflict parties into constructive negotiations, building on the initial co-operation and focusing on the plight of civilians.

Stefan Wolff
Bath, Somerset

SIR – A major problem with disaster relief is getting aid to the people who need it without it being skimmed off by corrupt politicians or well-paid bureaucrats. With billions pledged by rich nations already, the risk of waste is particularly high with the current crisis. To circumvent this, why not give, say, $1,000 to each person in the affected areas, and allow human ingenuity and enterprise to do the rest? It would make for a much more effective response.

Mark Weston
Wimborne, Dorset

SIR – I was wondering why Middle Eastern countries, some of whom are fantastically rich, do not appear on any list I have seen of countries that have donated money to the tsunami relief effort ("More generous than thou", January 8th). Am I missing something? Do they donate in other ways or do they prefer to donate in a more private way, thus not appearing on the radar?

Gareth Jones
Hong Kong

SIR – Bangladesh a "new state" in 1970 ("Asia's devastation", January 1st)? Whether in March, when the break with Pakistan was declared, or in December, when the new nation came into

existence, Bangladesh was born in 1971.

Deepak Banerjee
Delhi

Language difficulties

SIR – You say that the effort devoted toward the revival of Hebrew in Israel "more or less killed off another Jewish lingua franca, Yiddish" ("Babel runs backwards", January 1st). While Yiddish is no longer the daily and cultural language for the majority of the world's Jews, as it was a century ago, it is still the primary language for many Hasidic communities and thus very far from dead. In America, for example, there are more than 40,000 children being raised with Yiddish as their home language, a number that is growing steadily.

Joshua Comenetz
Gainesville, Florida

SIR – You state that Mayan "survived in writing but became extinct in daily life". Today, millions of Mexicans, Guatemalans and Hondurans speak Mayan languages that are directly related to "ancient" writings, many of which were carved less than 1,500 years ago.

Gerry Dempsey
New York

Germany's painful past

SIR – You show how painful it is for Germans to remember that their Nazi ancestors were abominable criminals ("A shift in the landscape", December 18th). Young Germans are as "guilty" for that era as young Americans or any other young man. Nevertheless, they do not want to be tied to evil and are less likely to forget history. Humanity should applaud Germany's efforts at remembrance as an example of how to come to terms with a horrendous past.

Laurent Bacot
Paris

SIR – You imply that all Germans share collective guilt for the second world war. As a veteran of D-Day, I felt remorseful at the time (but not guilty) for the actions of allied bombers for making human torches out of thousands of Social Democrats, in Hamburg and elsewhere, who had fought bitterly against Nazi street gangs for several decades. There is no such thing as the guilt or innocence of an entire nation. Guilt is, like innocence, not collective, but individual.

WILLIAM BURKE
San Francisco

Knowing your own mind

SIR – I noted Dave Townsend's letter suggesting that readers of *The Economist* seek to read, watch and listen to material that confirms their own political prejudices (Letters, January 8th). How fortunate that academics and "critical theorists" don't suffer from this problem themselves.

Adrian Fletcher
Letchford, Hertfordshire

The built environment

SIR – Your report on green buildings confuses two such buildings in Pittsburgh ("The rise of the green building", December 4th). The PNC Firstside Centre in Pittsburgh is wrongly labelled as the Pittsburgh convention centre. The benefit from such structures includes improvements in the health and well-being of employees. Also, building operating costs are significantly lower, including 10% reductions in energy bills. Customers are proud to do business with a socially responsible company, and communities favour new construction and economic growth with minimal impact on local resources.

Neil Hall
Pittsburgh, Pennsylvania

Picking berries

SIR – You say the cranberry is one of only three fruits native to North America ("Red, round and profitable", December 18th). In California, there is the little orange berry of a local native hardwood, the manzanita, that grows in easily plucked clusters which local Indians render to make a sort of bitter fizzy-drink.

Erica Rex
North Fork, California

SIR – The Saskatoon berry is native to western Canada and to the north-central United States. It was an important food source for indigenous peoples and wildlife during the winter. Blackfoot Indians used fresh berries in soups, stews, and pemmican. They were also used to make dyes and remedies for stomach-aches and liver problems. When dried, they were popularly traded.

Doug McClelland
Vancouver, Canada

May as well spend it now

SIR – You proffer a practical, material consequence of the belief of many evangelicals in a rapidly approaching end-time: "If it's all going to be consumed by fire...why worry about pollution or climate change?" ("It ain't necessarily so", January 1st). Could this kind of thinking also be a reason decision-makers in Washington, DC, expect wide acceptance of historically high and growing budget deficits?

Frank Kenter
Menlo Park, California

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George Bush's second term

The revolution comes home

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From The Economist print edition

AP

From the pensions system to the tax code, George Bush wants to overhaul America's economic institutions. Does his radicalism stand a chance?

MOST two-term American presidents lose steam in their second four years. If scandal doesn't get them (Watergate, Iran-contra, Monica Lewinsky), weariness does. Sitting presidents rarely campaign on a revolutionary agenda, just feel-good blather: Ronald Reagan's “Morning in America”, or Bill Clinton's “Bridge to the 21st century”. And a re-elected president is a lame-duck long before his second term ends, leaving little time to get much done.

George Bush seems determined to be different. He has laid out a second-term domestic agenda more ambitious than anything seen in the first term, and that was hardly a lull. It brought the biggest tax cuts since 1981, the broadest education reform in a generation and the costliest expansion of Medicare, the state health system for the elderly, since it was set up in 1965.

If the first-term legacy is largely a deficit, the second term promises to shake some of the country's economic pillars. At the Republican convention last September, Mr Bush spoke of transforming America's fundamental economic institutions for the 21st century, and offered two broad organising themes. The first was to make the United States the best place in the world to do business. That covered changes from tort reform (fewer burdensome lawsuits) to a simpler tax code, spurring more economic growth. The second theme was to foster an “ownership society”, by giving individuals greater control over, and responsibility for, their own health care and pensions. In particular, it meant restructuring Social Security, America's public pension system, by basing it

partly on private accounts.

Empty campaign promises? Not so. At his post-election press conference, the president left no doubt that he regarded his victory as a mandate for reform. “I earned capital in the campaign, political capital”, he said, “and now I intend to spend it.”

In recent weeks, priorities have been set. Tort reform is top of the list of first-term left-overs. In early January Mr Bush gave three speeches pushing laws to curb frivolous lawsuits. Top of the new list of second-term priorities is Social Security reform. Tax reform has been put off until a bipartisan presidential commission under two ex-senators, John Breaux and Connie Mack, has studied the issue; they have been asked to report by the end of July. No one expects much action on tax until 2006. In contrast, the White House has hinted that it wants to move on pension reform within the next few months.

There is more, though the other topics may be even more contentious. Judicial appointments are a top priority for Mr Bush's conservative base, but are certain to create a poisonous battle in the Senate. Immigration reform, particularly the creation of a guest-worker programme, will cause painful divisions within Republican ranks. Mr Bush may attempt them, all the same.

The president's ambition, coupled with increased Republican majorities in both the House of Representatives and the Senate, makes for heady expectations. Right-wing activists talk of a “conservative New Deal”, with Mr Bush changing America as profoundly as Franklin Roosevelt did in the 1930s. Democrats, equally exercised, accuse Mr Bush of fabricating a crisis in the pensions system, in particular, in order to destroy the fabric of modern America.

But just as the scale of the project has emerged, so the political landscape has become more difficult. According to Gallup polls, Mr Bush has the weakest job-approval rating of any newly re-elected president since 1948. High casualties in Iraq are the main reason, but the public also seems uninspired by much of this reform agenda. The Democrats are also surprisingly united in their opposition, particularly to Social Security reform. In the case of tax cuts, in the first term, several Democrats switched sides early on; but virtually none has defected in favour of private retirement accounts. Even centrist Democratic groups have come out against them. At the same time, congressional Republicans are both nervous about supporting pension reform and divided on how to go about it.

As a result, Washington's punditocracy has been whispering about over-reach even before the inauguration. Nasty comparisons are being made between Mr Bush's Social Security plan and Bill Clinton's disastrous efforts to overhaul America's health-care system in 1993. And Cassandras are crowing that Mr Bush's second term will be a spectacular failure.

The hyberbole on both sides is misplaced. Mr Bush's agenda combines the incremental and the radical, the sensible and the reckless, the politically doable and the impossible. Even under the most favourable circumstances, not everything will get done: Mr Bush has simply put too much on the table. But unless the White House loses its political touch entirely, some reforms will be pushed through.

Of torts and taxes

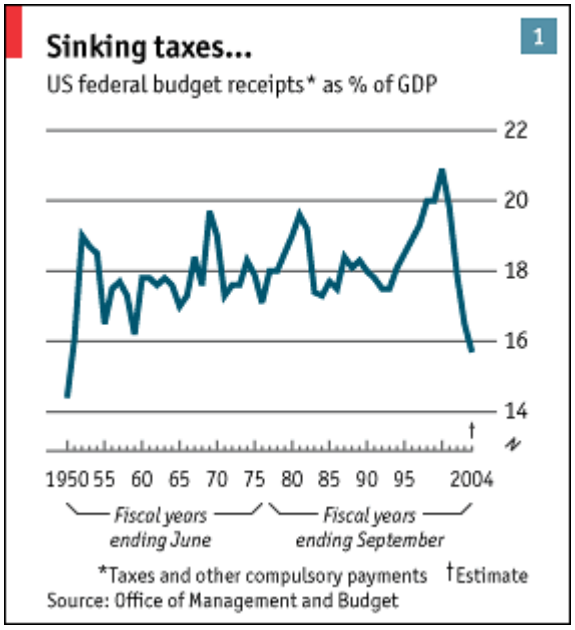
A few early signs are good. Of the various unfinished jobs from the first term, **tort reform** is the right one to focus on. The tort system—designed to compensate accident victims and deter negligence—is expensive, economically distorting and hideously inefficient. America spends over $230 billion a year, or around 2% of GDP, on these kinds of legal actions, far more than any other advanced economy. But victims of negligence get a remarkably bad deal. Over half the

compensation is eaten up by administrative costs.

Trial lawyers apart, few deny that America's tort system needs reform. And Mr Bush's basic ideas, though clearly a boon for his corporate cronies, are sensible. He wants to cap non-economic damages at $250,000; shift national class-action lawsuits from state to federal courts to stop plaintiffs shopping among the states for the highest pay-outs; and reform the rules for asbestos compensation. (Asbestos claims, by themselves, explain much of the recent rise in tort costs.)

Shaking up the tort system will not revolutionise America's economy. But it would save billions of wasted dollars and might boost productivity growth. The House has already passed Mr Bush's proposals; the sticking point has long been the Senate. That remains the case, but, with a bigger Republican majority and some judicious compromises, tort reform might actually happen.

That is more than can be said for other left-overs from the first term, particularly Mr Bush's first-term tax cuts. These officially expire by the end of 2010. Passing new legislation to make them permanent (or at least permanent until the size of the deficit forces a rethink) is high on the president's second-term agenda.



This obsession goes down well with conservative activists, who want all taxes cut at all times. From an economic and strategic perspective, it is misplaced. First-term tax cuts have already helped to reduce America's tax revenue, as a percentage of GDP, to its lowest level since the 1950s (see chart 1). If Mr Bush's new-found fiscal prudence is genuine (he promises to halve the budget deficit), he has no business making America's fiscal problems worse. More important, setting his first-term tax cuts in stone makes his bigger second-term goal of broad tax reform considerably harder to achieve. And although tax reform is likely to be much less ambitious than many conservatives now imagine, it will still be tough to do.

Mr Bush is right that America's tax code is a mess. The tax laws and their attendant regulations run to 60,000 pages, 10,000 of which were created during Mr Bush's first term. The annual cost of tax compliance is estimated at $115 billion. Simplifying the system by slashing its myriad deductions would be a big step forward.

And that is a large part of what Mr Bush intends to do. Although conservative ideologues dream of

killing off the income tax and replacing it with a flat tax or national sales tax, the White House has little truck with such radicalism. Mr Bush wants to improve today's system, not junk it. He approves of tax breaks for mortgage interest, as well as the need to keep incentives for charitable giving. His commission, tellingly, includes no prominent advocates of fundamental tax reform.

Incrementalism does not rule out ambition. If a simpler tax code is one Bush goal, the other is a code friendlier to savings and investment. The president's first-term tax cuts have already pushed in that direction, by slashing tax rates on dividends and capital gains. He would like to protect yet more investment income from taxation and allow firms to deduct investment spending up-front, rather than charging the depreciation of capital over time.

Paying for such changes (assuming Mr Bush has given up his first-term recklessness) means eliminating deductions. Two targets that the White House is said to be considering are the state-income-tax deduction and the tax-break firms receive for providing health benefits to their employees. Eliminating either would involve a huge political battle. Most Washington budget veterans scoff at the very idea, particularly since Mr Bush has already put off any action until 2006.

Some reform looks likely, however, thanks largely to the Alternative Minimum Tax. The AMT, which was originally designed to prevent rich Americans avoiding taxation, will hit 24m taxpayers by 2008, up from fewer than 3m in 2003. With luck, Mr Bush will marshal the political pressure from angry AMT-payers to push for some base-broadening reform. A clear political bargain could be arranged: elimination of the AMT in return for scrapping favoured deductions. The tax code will not be rewritten, but even modest improvements would be well worth having.

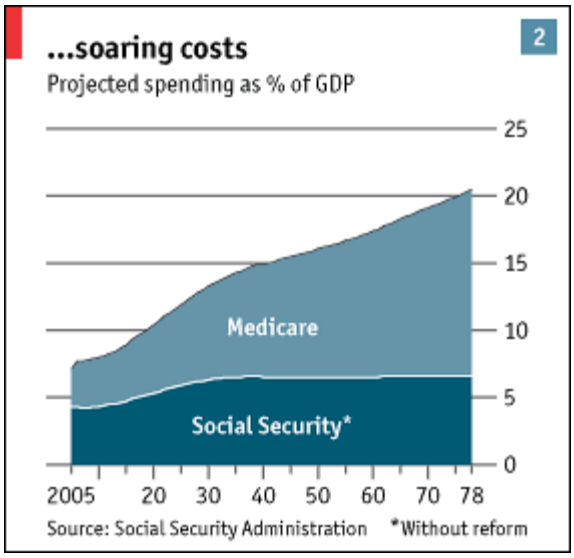
The Big Enchilada

On Social Security, in contrast, Team Bush has no truck with incremental change. A recent (leaked) White House memo described the reform project as one whose “scope and scale...are hard to overestimate”. Success in revamping Social Security, it went on, would “rank as one of the most significant conservative governing achievements ever”.

Social Security, created in 1935 by Franklin Roosevelt, is America's biggest and most popular government programme, providing pensions to the elderly and disabled. Thanks to Social Security, poverty among the elderly has been virtually eliminated. Most Americans rely on the programme for much of their retirement income.

As in most of the rest of the world, the combination of longer life expectancy and lower birth-rates will put increased financial pressure on this pay-as-you-go social insurance system. Over the coming decades, Social Security's payments will rise much faster than its revenues, which come from payroll taxes. The net present value of this financial imbalance over the next 75 years is $3.7 trillion, less than 1% of cumulative GDP. Over an even longer horizon, the present value of the permanent imbalance is estimated at around $10 trillion, a number Mr Bush loves to repeat.

These numbers can be hard to interpret, but the larger point is that Social Security is on an unsustainable trajectory, one that goes well beyond the retirement of the baby-boomers. It is not an immediate “crisis”. In fact, payroll-tax revenues will exceed pension payments until 2018, masking America's overall fiscal imbalance. Nor is it America's biggest long-term fiscal problem. The financial burden from Medicare will be much bigger (see chart 2). Mr Bush's first-term decision to introduce a prescription-drug benefit for retirees worsened Medicare's long-term financial imbalance by more than twice as much as the entire Social Security problem. Nonetheless, Social Security needs fixing. And that means either boosting revenues (for instance, by raising payroll taxes) or reducing promised benefits.



But cutting the pension fund's deficit is not what makes conservatives excited. Their most treasured objective is to restructure the system into one based partly on private accounts. Individuals would be allowed to divert a share of their payroll taxes into such accounts, gradually building up a pre-funded retirement nest-egg in return for a lower guaranteed benefit from the government.

Diverting payroll taxes would shrink America's biggest government programme and change the nature and scope of social insurance. According to its proponents, it would create a nation of investors (and hence, fear Democrats, of Republican voters), foster a savings culture and boost work incentives. On this logic, Americans would work harder, regarding the diversion of money into their own accounts as equivalent to a tax cut.

The scale of the change would depend on how big a share of payroll taxes was diverted. According to proponents, large accounts would not only have more emphatic effects on work and saving incentives, but, by capturing higher returns in equity markets, would do more (though at higher risk) to address Social Security's financial imbalance. On no plausible assumption, however, could private accounts eliminate it.

A small but vocal “free lunch” group of conservative Republicans disagrees. Large private accounts, they claim, can fix Social Security's finances with no need for benefit cuts or tax increases. Legislation proposed by John Sununu, a Republican senator, and Paul Ryan, a Republican congressman, proposes diverting half of payroll tax revenue with no reductions in promised Social Security benefits. The plan relies on permanent subsidies from the rest of the budget and wholly implausible cuts in spending outside Social Security to make its numbers add up.

Fortunately, Mr Bush has not been tempted by the free-lunch route, at least not yet. Though he has ruled out raising payroll taxes, the White House memo made clear it was a “bad idea” to push individual accounts alone. Instead, the White House is keen on a plan first proposed by the Bush-appointed Commission to Strengthen Social Security in 2001. This would allow individuals to divert an average of one-sixth of their payroll taxes into individual accounts. It would cut Social Security's future liabilities by indexing the calculation of initial retirement benefits to prices rather than wages. Although future retirees' pensions would stay constant in real terms, they would no longer rise in line with average wage growth. Over time, Social Security would replace an ever smaller share of workers' pre-retirement income, from 42% today for a typical worker to 20% in 2075 and ever less thereafter. This plan would involve substantial transitional borrowing (around

$2 trillion over the next decade alone), although this would be offset by a reduction in the government's obligations to future retirees.

Judging the risks

Until the details become clearer, it is hard to judge the merits of any White House plan. Economically, the benefits of private accounts—at least in the early years—are likely to be modest. A debt-financed transition will not boost national savings; though the accounts will imply higher private savings, government borrowing will rise by the same amount. The gain from private accounts might be eroded by high management fees or poor risk-management by account-holders. But, in principle, Mr Bush could craft a package that shores up Social Security's financial health and reaps the benefits of individual accounts, without sacrificing the basic nature of social insurance.

Less obvious is whether that is politically possible. Americans are increasingly concerned that Social Security is in trouble (in a recent *Washington Post* poll, more than seven out of ten said the system faced “major problems”). But while younger people like the sound of private accounts, polls suggest that Americans overall are almost evenly divided over whether people should be allowed to invest their payroll taxes in financial markets.

Mr Bush's success will depend on how well he explains his ideas. Interest groups are massing on both sides of the debate. The AARP, America's huge pensioners' lobby, is leading the opposition against the “risky” privatisation scheme. But money is also piling up on the other side, particularly from well-financed conservative lobby groups.

At present, the congressional maths does not look good. Congressmen who face re-election next year are terrified of talking about benefit cuts. Other Republicans are nervous about the upfront borrowing involved. To protect their political flank, party leaders have told Mr Bush that this scale of social change must be done with bipartisan support. But embattled Democrats are loth to give Mr Bush an inch, and the compromises that might appeal to them—such as raising payroll taxes—will appal conservative ideologues.

For all these reasons, Social Security reform will be a long, tough battle. Failure need not sink Mr Bush's whole agenda, but it will overshadow any progress elsewhere. Without pension reform, Mr Bush's second term will be as disappointing as most others. Success, in contrast, could place him beside Ronald Reagan as a true conservative revolutionary.

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America and its allies

Condi's challenge

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AP

Second term + new team = second thoughts?

IN THE January 2000 edition of *Foreign Affairs*, two eminent Republicans outlined America's main diplomatic tasks. “There is work to do with the Europeans,” wrote one. “Foreign policy in a Republican administration will most certainly be internationalist.”“In pursuing a reinvigorated foreign policy,” wrote the second, “the United States first needs to overhaul ties with its partners and allies.”

The two authors—Condoleezza Rice and Bob Zoellick—are about to become secretary and deputy secretary of state (subject to Senate confirmation). Their resolute-sounding internationalism is one reason why many people on both sides of the Atlantic are hoping, not for the first time, that the Bush administration's foreign policy may be about to change. As one European official has been quoted as saying, this is “the end of the period of war and the start of the period of politics”.

If there were ever a point when diplomacy might break out, it would probably be the start of George Bush's second term. For three years after September 11th 2001, the Bush administration was in full crisis mode, waging two wars, re-inventing a doctrine of pre-emption (or at least prevention) and changing the direction of foreign policy.

In the course of this period, the administration trod on toes and made unforced errors. It did not need Ms Rice to tell the re-elected Mr Bush last November that he needed to undo some of the damage. “In my second term,” the president told Tony Blair, soon after his victory, “I will work to deepen our transatlantic ties with the nations of Europe. I intend to visit Europe as soon as

possible after my inauguration." (He will come on February 22nd, in fact.) If traditional diplomacy suffered in a first term devoted to changing the world, perhaps it may flourish again in a second term devoted to changing America.

On the face of it, such hopes are plausible. The appointment of Ms Rice has been taken as a signal that the president, by asserting greater control over the State Department, may also be preparing to engage more with his allies. True, in the first term Ms Rice frequently sided with the bogeymen of America's friends, the vice-president Dick Cheney and Donald Rumsfeld, the defence secretary. But those who have invested hopes for better ties in her tenure argue that the fact that she has the president's ear is more important than the worry that she is less obviously multilateralist than her predecessor, Colin Powell.

Her choice of Mr Zoellick as number two confirms this hope. The US trade representative is the nearest thing the administration has to a traditional Republican internationalist (he served as counsellor to James Baker, the first President Bush's secretary of state). Several others in the running for top jobs in the new State Department—Nicholas Burns, the ambassador to NATO, and Philip Zelikow, the staff director of the September 11th commission—are cut from similar cloth.

Perhaps more important, there are signs that the administration is beginning to count the costs of its first-term policy. In much of that period, gung-ho members and their neo-conservative cheerleaders made a variety of arguments against paying real attention to the concerns of allies. Most of their arguments turned out to be wrong-headed.

One said that there was no point in making concessions because America's friends would always come round in the end. We lead, they follow. Yet nothing has shaken French and German opposition to the Iraq policy. And any hopes that the occupation would confer on America the legitimacy it failed to convince its critics it had before the invasion were dashed, principally by the failure to find any actual weapons of mass destruction.

What about the neo-conservative assurance that unco-operative allies were too weak to make any difference? In fact, some Europeans' unwillingness to send serious amounts of aid and training to Iraq has plainly hurt America. For instance, Iraqi security forces are less well trained than they would otherwise have been.

These truculent allies have also shown themselves capable of pursuing diplomacy in ways Mr Bush does not like. America refused to sign up to the Kyoto treaty. The climate accord was still ratified. America's closest European friends said they would not allow the European Union's defence pact (the European Security and Defence Policy) to have planning arrangements separate from NATO. But a planning cell was agreed upon.

The same thing could soon happen with China and the EU. After trips to China by the French and German leaders, the EU is planning to lift an arms embargo imposed on China after the 1989 Tiananmen massacre (see article). The administration is understandably apoplectic.

More generally, the administration is having to reconsider its lofty indifference to the EU. During 2002-03, the argument between European Atlanticists, such as Britain, Poland and Italy, and (for want of a better term) Gaullists—France and Germany—was evenly balanced, and America was able to pick up Atlanticist support for its Iraq policy. But since the fall of Spain's conservative government, debate within the EU has shifted towards the Gaullists. The Atlanticists have been tarnished by their association with Iraq—and so, potentially, have American interests in Europe.

A little more conversation

So there are solid reasons for second thoughts and, at least rhetorically, evidence of willingness to change. But by how much? Is real consultation in the offing? Or just better public relations?

At a press conference immediately after his election victory, Mr Bush defined what he meant by engagement with allies: “I will reach out to others and explain why I make the decisions I make.” In other words, engagement means explanation, not consultation. On November 30th, during his trip to Canada, the re-elected president was asked about polls showing America's reputation to be mud north of the border. “I haven't seen the polls you look at,” replied Mr Bush. “We just had a poll in our country where people decided that the foreign policy of the Bush administration ought to...stay in place for four more years.” That doesn't sound as if serious reappraisal is being contemplated.

Anyway, it is not clear what the basis would be for a policy convergence with allies, especially European ones. Take the wrangles over Kyoto and the International Criminal Court. A big effort by Mr Bush to curb pollution or a moderation of opposition to the International Criminal Court would be seen as a change of heart in Europe. But the Republicans want an industry friendly energy bill; and Mr Bush has nominated for attorney-general Alberto Gonzales, who called the Geneva Conventions on prisoners-of-war “quaint”.

The Europeans would like the Bush administration to applaud the efforts of France, Britain and Germany to negotiate an end to Iran's nuclear programme. Publicly, the administration backs the Europeans but on the less-than-ringing grounds that, as the president put it on December 20th, “we don't have much leverage with the Iranians right now”. And privately, American officials say negotiations are doomed to failure because the Iranians will break any agreement.

As for Iraq, the possibility of concord must await the elections. But whatever these achieve in Iraq itself, they seem unlikely to bring about a meeting of transatlantic minds. The administration seems prepared in advance to declare them a success, the Europeans to call them a failure. Meanwhile, talk in Washington is turning to how and when to get out of Iraq. Eventually, an American withdrawal might remove the sand from the transatlantic gears. But until then, disengagement would absorb all the administration's foreign-policy energy—and confirm to opponents of the Iraq venture that they were right all along.

There is one exception to this overall pattern of pessimism about policy agreements: Israel and Palestine. At his meeting with Mr Blair, Mr Bush was emphatic: “I intend to use the next four years to spend the capital of the United States on [a Palestinian] state.” This opening has come about, of course, because of a change in circumstances (Yasser Arafat's death), not because of any change in American thinking. It remains unclear whether Mr Bush intends to put stronger pressure on Israelis and Palestinians to come to terms, or whether he just wants to help build up Palestinian institutions and encourage Palestinian democracy.

At least on the Middle East there is some agreement on the aim of policy and on the roles of the various actors. That is not true in other arenas. The Americans complain that, in Iraq, they did what the Europeans wanted—transferred sovereignty, returned to the United Nations, arranged elections. But the Gaullists have barely moderated their hostility.

And now, ask members of the administration, what if we were to do what the Europeans want? Would they reciprocate? The administration wants at least political support on Iraq, and preferably much more material help. It wants the Europeans to agree that if they hit a dead end in Iran, they will support American calls for, say, UN sanctions. It wants the EU to stop criticising Israel's security fence and be more supportive of Ariel Sharon's pull-out from Gaza. And it does not want the arms embargo on China lifted.

Looking back over these competing demands, what is striking is how potentially close the

transatlantic allies look on some points—Palestine notably, even Iraq. Yet, in reality, the sum of disagreements and the apparent unwillingness to compromise on much must mean that America's relations with its allies will remain fragile—and vulnerable to big looming disagreements, such as on China. At most, the new team at the State Department may break the vicious cycle of the past three years. But it seems some way from replacing it with a virtuous one.

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The Supreme Court

Less chaos, more uncertainty

Jan 13th 2005
From The Economist print edition

A tangled ruling ends up giving judges more power on sentencing

LAST June, in the case of *Blakely v Washington*, the Supreme Court struck down Washington state's mandatory sentencing guidelines. It ruled that juries, not judges, should decide on factors that could lengthen a defendant's prison term. Since then, courts across the country have been issuing wildly different opinions as to whether the *Blakely* ruling affected similar systems at federal level and in a dozen other states. Some have been slashing sentences. Others have been throwing cases out altogether.

In response to increasingly anguished pleas for clarification from judges, lawmakers and the federal government, the Supreme Court agreed to hold expedited hearings on the first day of its new term, October 4th. This week it finally issued its ruling: *Blakely* applied equally to the federal system too. Federal judges, it decided, have been improperly required to increase criminals' sentences. But the court stopped short of discarding the whole of the 17-year-old federal sentencing system.

Some 64,000 federal cases a year will be affected. Yet reaching a decision evidently proved much tougher than expected. In the end, the nine justices divided along the same odd lines as in the *Blakely* ruling, with two of the most conservative, Antonin Scalia and Clarence Thomas, siding with three of the court's most liberal members, Ruth Bader Ginsburg, David Souter and John Paul Stevens, in the majority.

Ruling in two federal drugs cases, the court said the guidelines improperly required judges to increase the range of possible sentences on the basis of their own factual findings made “on the preponderance of the evidence”, rather than on the basis of evidence determined “beyond reasonable doubt” by a jury. This violated a defendant's constitutional right to a trial by jury.

The problem lay in the mandatory nature of the guidelines, which might, for instance, require a sentencing judge to increase a drug dealer's punishment in line with the size of his stash. If such a guideline were merely advisory, the court said, it would not be unconstitutional: so the sentencing rules can stay on that basis.

The result of this tangled ruling? Individual judges will actually have greater discretion, so there will be greater sentencing disparities between courts. That was the situation that the guidelines were intended to abolish.

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Homeland security

The new tsar

Jan 13th 2005 | WASHINGTON, DC
From The Economist print edition

EPA

A tough guy for the hardest job in the cabinet

Get article background

IN CHOOSING Michael Chertoff, an appeals court judge, to head up the giant Homeland Security Department, the White House plainly hopes it has found the safe option. Its first choice, Bernie Kerik, New York's tough-talking former police chief, also looked pretty good—at least for a day or so. Officially, Mr Kerik's nomination sank because of his employment of an illegal immigrant; but enough skeletons spilled out of his closet—an arrest warrant, friends with mob connections, an unacknowledged marriage, affairs and much more—to fill 20 confirmation hearings.

With his second choice, George Bush has picked a hard-nosed prosecutor. The former head of the Justice Department's criminal division, Mr Chertoff took on corporate titans such as Enron and Arthur Andersen; he also spearheaded the department's anti-terrorism drive. Previously, he had hunted down Soprano types as a prosecutor in New Jersey.

Prominent Democrats have praised Mr Chertoff's credentials. Though a loyal Republican, he isn't seen as an ideologue. He has even received a (somewhat perfunctory) welcome from Hillary Clinton. Mr Chertoff led the Republican Senate committee's special investigation into the Clintons' land dealings in Arkansas; Senator Clinton had been the lone dissenting vote in Mr Chertoff's appointments to the Justice Department in April 2001 and the bench in June 2003.

That does not mean that Mr Chertoff will be a good homeland-security tsar. Civil libertarians worry

about his championship of the Patriot Act and his oversight of the legal war on terror. These may be valid concerns (none of the more than 700 foreign nationals detained since September 11th on immigration violations has been charged with a terrorist offence), but they are unlikely to be taken up by a Republican Congress. Meanwhile, Mr Chertoff has backed off from his previous support for detaining enemy combatants indefinitely.

The bigger challenge is whether a prosecutor with little management experience can force together an 180,000-person department that has patently yet to gel. Homeland Security, which was forged out of 22 agencies in 2003, is also stuck in countless turf battles with more established bureaucracies. Who knows how it will cope with another terrorist attack?

Some think the quibbling over Mr Chertoff's experience is a canard. “I'd like to know who has experience running federal mega-agencies?”, asks Will Marshall of the Progressive Policy Institute. Viet Dinh, a former member of the Justice Department, points out that his colleague managed to corral 93 headstrong federal attorneys' offices together to co-ordinate strategy in the wake of the terrorist attacks on September 11th.

Others promise that, when it comes to bureaucratic infighting, Mr Chertoff, who has something of the fiendish Mr Burns in “The Simpsons” about him, will be a match for Donald Rumsfeld et al. No matter what happens at his confirmation hearings, Mr Chertoff will surely fit in better at cabinet meetings than Mr Kerik.

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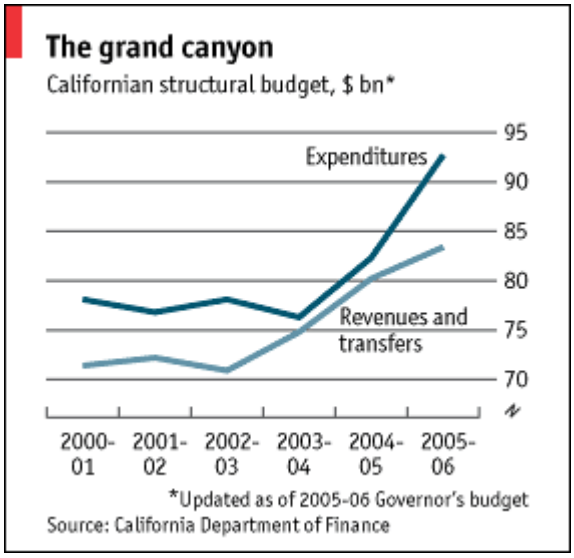
California's new budget

Fire with fire

Jan 13th 2005 | SACRAMENTO
From The Economist print edition

Tough new proposals from Arnold Schwarzenegger



Get article background

WHY should the government of the world's sixth-largest economy be permanently broke? Arnold Schwarzenegger has an answer. Proposing a $111.7 billion budget (larger than the annual GDP of three-quarters of the world's nations) for the year beginning in July, California's governor declared in his familiar robotic tones: “If we don't get control of the autopilot spending there will be deficits as far as the eye can see...Cruise-control spending is out-of-control spending.”

He has a point. State revenues for the coming year are expected to grow by 6.8%, but various voter-approved mandates mean that spending, unchecked, would grow by 12.6%. The Republican governor's solution is to cut back heavily in the non-mandated bits, fiddle with the mandated bits and borrow the rest.

Thus the “general fund”, which represents four-fifths of the total budget, will grow by just 4.2%. He will fiddle into the general fund some $1.3 billion that is supposed to be mandated for roads, while declining to give the state's schools some $2.3 billion owed to them under Proposition 98 (which says that 40% of the general fund must go to education). And he will borrow another $1.7 billion (already approved).

It says a lot about Californian politics that this is actually a more honest budget than normal: it is certainly better than Mr Schwarzenegger's dodges with putative Indian gambling receipts last

year. And it has the happy result of closing a deficit that would otherwise be some $9.1 billion.

Happy is perhaps not the right word. The schools are furious: they accepted a $2 billion cut in the present year's budget on the understanding it would be made up in the 2005-06 year. Moreover, the governor wants the state to save some $469m by eliminating its annual payment to the teachers' defined-benefit pension scheme, though he is also offering the teachers a cash bribe to opt out of that system.

Teachers are not the only ones to suffer. The governor envisages saving $741m by giving some 325,000 state employees unpaid days off; eliminating two days of their holidays; cutting their overtime payments; and requiring them to fund one-half, rather than one-quarter, of their future pensions, which they are also being bribed to forgo.

The Democrats claim that Mr Schwarzenegger's real victims are the working poor. Some 6.6m elderly, disabled or poor Californians benefit from the Medi-Cal health-insurance programme. If the governor has his way, Medi-Cal recipients above the poverty line will have to pay monthly premiums, up to a cap of $27 a family. Moreover, welfare grants will be cut, cost-of-living adjustments will be ended, and payments to the old, the blind and the disabled will be frozen.

Both the gubernator's cuts and the Democratic howls are opening gambits in a long chess game. Significantly, the Democratic legislature is not calling for tax increases, even though another hole in the budget is forecast for 2006-07. The lawmakers have until June 15th to come up with their own budget proposal, and their wrangling will take place under the threat of a special election that the governor will call to amend the state's constitution and end “autopilot” spending once and for all.

Given that the governor's approval rating, at over 60%, is at least double that of the legislature, what he wants from the special election he may get. In particular, his plan has a “budget-control proposal” requiring across-the-board cuts whenever spending exceeds revenues. “I propose we fight fire with fire,” he said this week. “Instead of a formula compelling more spending, we should have a formula that forces us to live within our means.”

But the governor too might be prepared to compromise—for instance by accepting another way to ditch the autopilot. Tom McClintock, a Republican state senator, wants to bring back the “Gann Spending Limit”, which from 1979 to 1990 restricted spending increases to inflation and the growth in population. He also advocates reducing budget votes to a simple majority, instead of the present gridlock-inducing two-thirds; and he would restore the authority the governor enjoyed from 1939 to 1983 to make cuts by himself whenever spending ran ahead of revenue.

A couple of years ago there was the same degree of political aggro, but none of the inventiveness. The fact that ever more people in Sacramento are considering sweeping reforms is a sign of how far Mr Schwarzenegger has moved the debate.

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Washington state politics

Kiev by the Pacific

Jan 13th 2005 | SEATTLE
From The Economist print edition

Two months late, Washington state has a governor. But was the election fair?

ON JANUARY 12th, Christine Gregoire took the oath of office as Washington state's new governor. Nothing unusual in that, you might say. But the Democrat had been declared the winner only a few days beforehand, in what is by some reckonings the closest governor's race in America's history. And that tussle may well not be over yet.

AP

Beware the orange people, Christine

Ms Gregoire was not the initial winner: the first tally after the November 2nd vote put the Republican, Dino Rossi, 261 votes ahead. An automatic recount narrowed his margin to 42 votes. The 2.8m votes were then recounted, this time by hand, and Ms Gregoire won by 129.

Further retallying could be necessary. Election officials in King County, which contains Democratic-leaning Seattle, have admitted to a wide range of errors: counting 348 “provisional” ballots before they could be verified as coming from registered voters; counting hundreds more ballots than the number of voters listed as having cast them; dead people voting with the help of next-of-kin who filled in and signed mail-in ballots. Other counties had similar problems, and some members of the armed forces claim they received their ballots too late to use them.

Earlier this month, the state Republican party sued to have the election overturned. A judge in Chelan County, a conservative place where Mr Rossi won 63% of the vote, was due to start deciding the suit's merits on January 14th. Whatever happens, the loser will promptly appeal to the Washington State Supreme Court, which will probably get the case at the end of the month.

Most Republicans insist there should be an entirely new vote, not just a recount. “There was just a cascade of errors,” says Chris Vance, the chairman of the state Republican Party. “It's impossible to know who really won.” In a state not known for the animosity of its politics, that view is shared by a surprising number of people. Stuart Elway, a local pollster, says that his surveys (taken in late December) show that most voters felt that the election was inconclusive or even fraudulent; only 65% of Democrats acknowledged Ms Gregoire as the clear, fair winner.

Despite this, the local Democratic honchos are fighting hard to ensure that Governor Gregoire becomes a *fait accompli*. Earlier this week, the Democrat-controlled state legislature rejected Republican efforts to delay the election certification (and thereby the inauguration). Outside, demonstrators, clad in the same orange that reformers in Ukraine wore to protest their stolen

election, shouted for a new contest. These protesters will doubtless move on to the state Supreme Court.

In one way, Washington state was merely unlucky. Its problems—inconsistent voting procedures, antiquated voting equipment, sloppy vote-counting—could have happened in any state, argues Paul Gronke, an elections expert in Portland, Oregon. In 2002, spurred on by the Florida recount, Congress passed the Help America Vote Act (HAVA), which was supposed to improve things. But only a small fraction of the $3.9 billion appropriated for the measure has reached states, and even then it has sometimes caused trouble: California's secretary of state has been accused of mishandling $46m in HAVA funds.

The current embarrassment will spark some form of clean-up in Washington state; there is also talk of change in California, Virginia and Ohio. But in America even national elections remain local affairs, with polling places and procedures determined by individual counties. Imposing rules of any sort is unpopular with county auditors, polling officers and the other people who rule the roost in the current system.

If Washington's Supreme Court insists on a revote, it would take place on April 26th. In the meantime, Governor Gregoire and the legislature will have to attend to other business, including a $1.6 billion budget shortfall. It could be an uncomfortable few months for Washington's new—or at least apparent—governor.

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Lexington

Brother, where art thou?

Jan 13th 2005
From The Economist print edition

Don't expect to see the back of the Bush dynasty in 2008

FOR the thousands of Republicans who are descending on Washington, DC, Inauguration Day presents a cornucopia of opportunities. It is a chance to pay their respects to the leader of their tribe. It is an excuse for some serious partying. And it is an occasion to chew the fat about the future: not just that of the Republic, with reform of Social Security and the like, but also about an altogether more absorbing question, the future of the Republicans. To wit: who on earth is going to fill George Bush's boots when he returns to Texas in 2009?

This is an unusual problem. Vice-presidents traditionally get the first crack of the whip, whether their bosses want them to or not. But this time round Dick Cheney, a man who has already had four heart attacks, has made it clear that he doesn't want the top job. This creates a unique opportunity: an ascendant Republican Party with a looming vacancy at the top.

There is no shortage of candidates to suit all Republican tastes. Blue-state Republicans have Rudy Giuliani, George Pataki and Mitt Romney. Social conservatives have Rick Santorum and Bill Owens. Establishmentarians have Bill Frist. Mavericks have John McCain and his buddy Chuck Hagel. Republican revolutionaries may well have Newt Gingrich (who is using the publication of his new book to test the waters). But the best candidate by far is a man who dare not speak his surname: Jeb Bush.

Think of all the qualities that make an ideal Republican champion and Jeb has them in spades. He is the governor of the archetypal swing state: Florida is a multicultural hodgepodge with a red-state north, a blue-state south and 27 electoral votes. He is something of a multiculturalist

himself: his wife was born in Mexico, his three children were once dubbed “the little brown ones” by George senior, and he is a convert to Roman Catholicism. Neatly, his governorship runs out in 2006.

The Bush family has always regarded Jeb as the bearer of the family fortunes. He was not only much more hard-working than his elder brother (he started kindergarten a year early and graduated from the University of Texas in two-and-a-half years). He was also much more ambitious; as a child he wanted to become president, while George wanted to be a baseball star. One of the family's biggest political surprises came in 1994, when George won the governorship of Texas while his “big little brother” (Jeb is five inches taller than George) went down to defeat in Florida.

But Jeb is not just a goody-two-shoes. He is more of an ideological conservative than his elder brother. He drank deep of the products of conservative think-tanks at a time when George was drinking deep of the world's distilleries. During his first term as governor he slashed taxes by more than $1 billion, introduced America's first statewide school-voucher programme, appointed a pro-life Catholic to the state's Supreme Court, spoke of “blowing up” state agencies and took on just about every Democratic interest group imaginable, from the teachers' unions to minority lobbies. But he manages to hide what he describes as his “head-banging” conservatism behind an emollient exterior.

Only one problem haunts this gold-plated CV: the family name. The Bush family is now the most successful political dynasty in American history. The Kennedys racked up barely 1,000 days in the White House; the Bushes will have done four times that by the time George W. finishes his term. But would Americans really vote for a third Bush president in 20 years?

No less an authority on the subject than the matriarch of the family, Barbara, thinks the answer is no. She has proclaimed that two Bushes in the White House may be enough—for now. But it is easy to overestimate America's instinctive hostility to dynasties. Americans may be allergic to English kings, but look at their fondness for a line of Adamses, or Roosevelts, or Tafts. “We'll have Jack for eight years, Bobby for eight and Teddy for eight,” went a joke in the early years of the Kennedy administration. And both Bobby and Teddy ran for the presidency.

Dynasties bring huge benefits as well as potential costs. The Bush brand is worth millions in advertising, and it gives Jeb access to the most powerful fund-raising machine in American politics. The potential costs can be minimised if the other side can also be tarred with the dynastic brush. Hillary Clinton is currently ahead of the field of potential Democratic candidates. If she decides to make a run for the presidency—and Hillary signs are already appearing in Washington—then Jeb can reap all the benefits of his name while incurring few of the costs.

Deep in the shrubbery

The case for sticking with the Bush formula becomes even stronger when you look at the other Republican candidates. To the party's increasingly conservative rank-and-file Mr Giuliani is a pro-choice divorcé who once roomed with a gay couple, John McCain an ageing maverick who was rude about the Christian right, and don't even get them started on Ah-nuld's past. The others look either too partisan to sell to the general public (like Rick Santorum) or just too boring to excite anybody (like Mitt Romney). Bill Owens, the governor of Colorado, saw his star fall when his party lost both chambers of the state legislature; Rick Perry, the governor of Texas, could face a bloody primary challenge from Senator Kay Bailey Hutchison; Bill Frist, the Republicans' efficient leader in the Senate, lacks star quality.

There is a chance that Jeb will ignore the weakness of his rivals and sit on his hands in 2008 (his

friends say he is tortured by the dynasty question). But he is also a man who has devoted his entire life to politics and who has a notoriously competitive relationship with his elder brother. And don't think it will stop with Jeb. His handsome son, George P. Bush, has conspicuously left university to work as a teacher in a run-down school.

Next Thursday will mark the third time that a Bush has taken the oath of office. It may not be the last.

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Venezuela

And now your ranch is ours

Jan 13th 2005 | SAN CARLOS, COJEDES
From The Economist print edition

EPA

The rights and wrongs of agrarian reform, Chávez-style

Get article background

FOR any self-proclaimed revolutionary keen to polish his anti-imperialist credentials the cattle ranch of El Charcote in Cojedes, a state in Venezuela's northern plains, is a tempting target. Its 13,000 hectares (32,000 acres) of sprawling pastures and woodlands are owned—along with a dozen other ranches elsewhere in the country—by Britain's Vestey Group. It tops the list of what Hugo Chávez, the country's leftist president, sees as under-used latifundia, ripe for handing out to his peasant supporters.

Mr Chávez has not resisted temptation. On January 8th, the clatter of helicopters over the ranch heralded the arrival of Jhonny [sic] Yánez, the *chavista* governor of Cojedes, bearing the country's first “intervention order” against rural property. He was accompanied by some 200 troops and heavily armed police commandos. Mr Yánez, a former army captain, announced that private property was “a right, but not an absolute right”.

A state commission now has three months to decide whether the ranch is “unproductive” or not legally held and thus can be turned over to peasant co-operatives under a controversial land-reform decree of 2001. Since Mr Yánez had bused in potential members of the future co-operatives to the ceremony, the decision is hardly in doubt. The Vestey family may be as famous in Britain for its long history of (legal) tax avoidance as for meat (it has investments in beef and sugar in Argentina and Brazil as well as in Venezuela). But its title to El Charcote goes back a century and has been upheld by the courts.

Two days later, Mr Chávez set up a similar commission at national level. Its task is to speed up and bring order to the president's land-reform drive. This has featured much incendiary rhetoric, a proliferation of land-reform agencies, six ministers and the abolition (since reversed) of the agriculture ministry. It has also prompted hundreds of land invasions and the killing of dozens of peasant activists by opponents. But very little land has been awarded. “That's a self-criticism the revolution has to make,” says Rafael Alemán, the official in charge of the review at El Charcote. “We have not pushed this process forward.”

The case for land reform in Latin America is a powerful one—albeit less so than it was. In Venezuela, over 75% of farmland is controlled by fewer than 5% of landowners. Rural poverty is a visible blight. Unequal land distribution is one of the historical causes of the wider inequality that scars Latin American societies. It is, says Mr Chávez, “an injustice” that must end.

Yet nine out of ten Venezuelans now live in cities. The government itself is by far the largest rural landowner: it owns more than 8m hectares of farmland, at least half of which has never been properly surveyed. It has no data on how many peasants need land, nor where they are. Land reform is not new: the democratic governments of the 1960s and 1970s (now much reviled by Mr Chávez) distributed 13m hectares of land to some 400,000 families. But it was (and still is) hard to make a living from farming. Oil wealth distorted the economy, millions left for the cities and land distribution remained skewed.

Mr Chávez says land reform will offer “food security” as well as helping poorer peasants. But critics say his policies have the opposite effect. By harrying the private sector, the government has merely intensified Venezuela's dependence on oil—and all the economic distortions that go with that. The government says Venezuela imports 70% of what it eats. The opposition retorts that food imports have risen by a fifth since Mr Chávez came to power, while agricultural production has fallen.

Land reform of the *chavista* style carries heavy costs. The president's promises have encouraged both genuine peasant groups and opportunists to invade farms. Mr Chávez controls the courts and the National Assembly. So politics rather than law will determine who loses land—and who gets it. “Social justice cannot be sacrificed to legal technicalities,” Mr Yánez says. This assault on property rights is likely to scare off investment.

Back at El Charcote, herds of Brahma cattle still graze. The Vestey company normally supplies 4% of the beef consumed by Venezuelans. It has been a pioneer in genetic improvements to the national herd. But Diana dos Santos, the firm's local boss, says that at El Charcote all but one small pasture has been invaded; beef output has slumped. More than a thousand interlopers have put up rickety shacks and planted crops on the estate. They support the president—but despise Mr Yánez. So they may be evicted in favour of other, more reliable, political clients. And in a few years' time these in turn will probably end up back in urban slums, while Venezuela will have lost a source of wealth.

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Argentina's debt

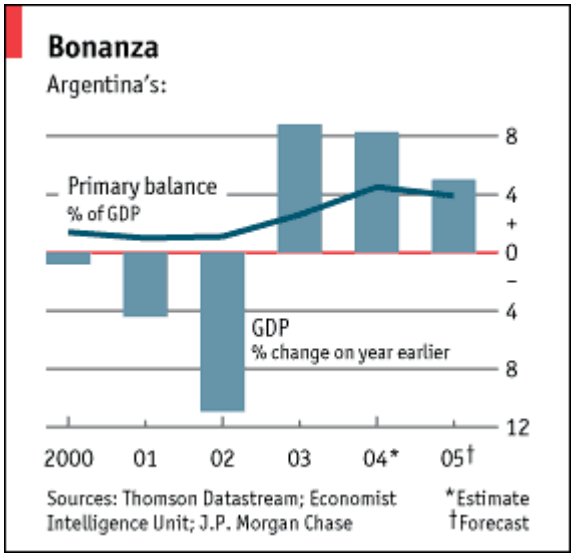
Grinding them down

Jan 13th 2005 | BUENOS AIRES
From The Economist print edition

Brutal tactics may pay off—for now

Get article background

IT HAS taken three years of stonewalling and bad-mouthing. But this week Argentina's government formally issued its take-it-or-leave-it offer to holders of $81 billion of bonds on which it defaulted in December 2001. The terms are harsh. Even so, most bondholders will probably accept them. What is less clear is whether this will be enough to turn Argentina's powerful recovery from economic collapse into sustained credit-driven growth.



At a series of presentations around the world due to start on January 14th, Argentine officials will present creditors with a choice of 16 different bonds in four currencies. One set aimed at individuals maintains its face value, but pays little interest and will not mature until 2038. Another, aimed at investment funds, involves a loss of two-thirds of face value but pays more interest. In all cases, the present value of the new bonds is barely above 30 cents per dollar originally invested. This write-down is nearly twice as big as the average in recent sovereign-debt restructurings.

Many bondholders are furious. They say Argentina, whose economy is growing strongly (see chart), could pay more. That is debatable. Even if most bondholders agree to the swap, Argentina's public debt would still stand at a whopping 80-90% or so of GDP. But what can the bondholders do? The government has few assets abroad that its creditors could seize.

Argentine officials have kept up their bullying tone to the end: they vow not to pay a cent to those who reject the deal. They know that co-ordination among hundreds of thousands of investors is hard. Much of the debt is held by locals or by “vulture” funds which bought it cheap.

Despite Argentina's rough treatment of its creditors, emerging-market debt has boomed over the past 15 months. So the potential resale value of the new bonds has risen, adding ten cents or so on the dollar to the offer. Even so, there is a risk. In the past, foreign courts have tended to award full repayment to bondholders who stick it out. Even if only a minority do, this could be costly. But a “successful” debt deal would allow Argentina to resume talks with the IMF on rolling over the $14.4 billion it owes the Fund. The government has defined success as swapping at least 50% of bonds; the IMF says 80%.

If Argentina's gamble pays off, President Néstor Kirchner will make the popular claim that he has outfaced the IMF and foreign “speculators”. But even a successful deal will leave a sour taste in the capital markets. The government's calculation is that it—and the economy—can live without foreign financing. Thanks to booming prices for its farm exports, and extraordinary taxes on them, the government racked up a primary fiscal surplus (ie, before debt payments) of 4.2% of GDP last year. The new bonds' long maturity and low interest rates should make debt service manageable. Meanwhile, officials say that investment will come from Argentines' repatriating capital to supply buoyant domestic demand.

The trellis underpinning such rosy reckonings is a booming world economy awash with cheap money. If and when those conditions change, Argentina could find itself in trouble again—and with no stock of goodwill.

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Cuba's economy

With help from oil and friends

Jan 13th 2005 | HAVANA
From The Economist print edition

Castro blunts Bush's offensive

OFFICIALLY, 2005 has been dubbed “the Year of the Bolivarian Alternative” by Cuba's communist government. No matter that Simón Bolívar was in fact a capitalist landowner; the liberator of much of South America from Spanish colonialism happens to be the hero of Venezuela's president, Hugo Chávez. And in the twilight of Fidel Castro's rule, Mr Chávez has become his main foreign supporter. Partly because of that support, the island's economy is enjoying a modest uptick—despite George Bush's efforts to strangle Cuban communism by tightening America's trade embargo.

Last month, Mr Chávez and Mr Castro signed a new version of their co-operation agreement, promoting a “Bolivarian alternative” to the American-backed Free-Trade Area of the Americas, a moribund plan for a 34-country hemispheric trade pact from which Cuba was excluded. They agreed to abolish tariffs on each other's imports, and allow their state companies to operate freely in either country. But the core of their relationship remains a swap of Venezuelan oil, and money for infrastructure, for Cuban political support for Mr Chávez. For several years, Mr Chávez has sold Cuba oil on preferential terms—at least 53,000 barrels per day (b/d) last year, or around a quarter of the island's total consumption. Meanwhile, some 15,000 Cuban doctors and nurses and a similar number of teachers, sports trainers and other advisers are working in Venezuela. Under the new agreement Venezuela will pay for these (the amount is secret).

When he addressed an end-of-year meeting of Cuba's National Assembly—one of his first public appearances since breaking his knee and arm in a fall—Mr Castro had other victories to report. China has offered cheap loans for an electronics plant and to refurbish crumbling hospitals. It has also shown interest in Cuba's nickel deposits. Two Canadian companies, Pebercan and Sherritt International, have found a small new oilfield off the north-west coast, estimated to contain 100m barrels. The oil is heavy, and must be mixed with lighter imported crude for refining. But officials hope for more discoveries—Spain's Repsol is exploring in deep water in the Gulf of Mexico. Since Mr Castro began giving licences to foreign oil companies in the early 1990s, production has quadrupled to 75,000 b/d.

Cuban officials are happy, too, that this month the European Union called off an 18-month dispute, the so-called “cocktail war”. This began when Mr Castro's government jailed 75 members of the small democratic opposition. EU countries responded by inviting dissidents to national-day receptions. That prompted the government to freeze contacts with EU embassies. Spain's new Socialist government abandoned the common policy in October—and following Cuba's release of 14 of the prisoners last year, the rest of the EU has now followed suit.

Booming tourism has helped Cuba to recover from the collapse of the Soviet Union a decade ago. The past few months have been difficult, with hurricanes, a drought, power cuts and new curbs on visits by Cuban-Americans ordered by Mr Bush. Even so, the Economist Intelligence Unit, our sister company, puts last year's growth at 3% (5% says the government). Thanks mainly to

Venezuela, China and oil, the growth rate may now edge up. Mr Castro's response to slightly better times has been to roll back many of the timid market reforms he decreed in the mid-1990s. So don't expect 2006 to be called the Year of Deng Xiaoping.

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Honduras

After the massacre

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From The Economist print edition

Youth gangs and drug barons: a marriage made in hell

AP

Terrorist, scapegoat or hired gun?

EVER since Ricardo Maduro became president of Honduras three years ago, his government has been waging a low-intensity war against the youth gangs known as *maras*. Yet even by the standards of this increasingly violent conflict, the slaughter that occurred just before Christmas was shocking. In the evening of December 23rd, on the outskirts of the industrial city of San Pedro Sula, a bus laden with people returning from work or Christmas shopping was stopped on a main highway by heavily armed gunmen. During the next five minutes, the men proceeded to machinegun the passengers, leaving 28 dead and almost all of the rest wounded. Most of the victims were women and children. Worried officials fear that this savagery is evidence of a new link between the *maras* and drug mobs. Others say it merely shows that repression has failed to deal with a social problem.

The Christmas massacre stood out mainly for its scale. But it was not the first such atrocity. In August 2003, for example, 13 people were killed when three buses were hijacked in San Pedro Sula.

Nobody has been convicted for any of the killings. But the government was quick to blame the December massacre on the Mara Salvatrucha (MS), the largest of the youth gangs. Police have arrested 11 of its members. The origins of the MS lie in Los Angeles, whither many Salvadoreans fled to escape the punishing civil war of the 1970s and 1980s. Their children imbibed the city's gang culture, and on their return spread it throughout Central America—and especially to Honduras.

Mr Maduro campaigned on a platform of “zero tolerance” of the gangs. His government has reformed the penal code to allow judges to hand out long prison sentences for merely belonging to one. That has filled the jails: in May, 103 prisoners, most of them gang-members, died when fire swept through a grossly overcrowded prison in San Pedro Sula.

Officials claim that in many respects the government's crackdown on crime is working. Ramón Romero, the president's special adviser on public security, says that there was only one kidnap last year, down from 18 in 2001. Over the same period, bank robberies have fallen from 70 to single figures. Drug seizures have risen, from an annual 45 kilos to 15 tonnes. Mr Romero claims that in response to this success, Honduras now faces an “organised campaign” of “terrorism” and intimidation by drug mobs from Colombia and Mexico. They use the country as a transit point. Officials suspect that the *mareros* are now acting as hitmen and mules for the drug mobs, and that

they carried out the bus massacre to order. A long letter was left on the bus threatening Mr Maduro and other politicians from his party.

If this claim turns out to be true, a marriage of the numbers and desperation of the *maras* with the power and wealth of the drug mobs would be frightening. It holds out the prospect that Honduras—one of the poorest countries in the Americas—might fall under the sway of criminal syndicates. But it also suggests that the government should do what it can to drive a wedge between the *maras* and the drug barons. That would require more subtle policies towards the gangs, whose members are usually no more than angry, bored victims of broken homes and soaring youth unemployment. But it may already be too late for that.

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Health care in Canada

Cross-border headache

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A dispute over internet pharmacies

NORTH of the 49th parallel, the government pays for most pharmaceutical drugs and controls their prices. South of it, drug companies are free to set prices as high as the market will bear. The result: some branded drugs are at least a third cheaper in Canada than in the United States. This disparity has spawned a growing cross-border trade in prescription drugs—and now a rumbling political row in Canada.

It began with busloads of elderly Americans travelling north to buy their medicines. They were joined by legislators from states such as Illinois and Wisconsin, seeking budget economies. Some 270 online and mail-order pharmacies based in Canada have now entered the market. They receive prescriptions from American doctors, which are then signed off by Canadian medics before the drugs are popped in the post. In all, drugs worth perhaps $700m flowed south across the border in 2003.

The Bush administration—and, less surprisingly, the drug industry—takes a dim view of this trade. Last month, a report from the Department of Health and Human Services said that Americans buying drugs abroad are running “a significant risk” since the safety of such products is hard to verify (no more so than those approved by the Federal Drug Administration, cynics might retort). It is illegal for individuals to import foreign pharmaceuticals into the United States, though hitherto this ban has seldom been enforced.

Canada's government is starting to worry too. Ujjal Dosanjh, the federal health minister, fears that Canada could face drug shortages. Others worry that drug companies might limit supplies to the country. He is looking at ways to halt the trade, such as banning the export of some drugs or requiring Canadian doctors to see the patient before signing a prescription (which would kill the internet trade).

But any crackdown will spark a political battle. Regulation of doctors and pharmacists is mainly a matter for provinces or professional bodies, not the federal government. And at least one province objects to Mr Dosanjh's plans. Gary Doer, the premier of Manitoba, where 2,000 work in mail-order or online pharmacies, has vowed to defend those jobs against Ottawa. In fact, there is little evidence that the cross-border trade has caused widespread drug shortages—and it is unlikely to unless large-scale American buyers are allowed to source drugs in Canada. According to Steve Morgan, of the University of British Columbia, a far bigger problem is a shortage of pharmacists. Graduates are snapped up by internet pharmacies, leaving hospitals and corner drugstores short-staffed—especially in Manitoba.

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Indonesia after the tsunami

And then the politics returned

Jan 13th 2005 | BANDA ACEH
From The Economist print edition

AP

Indonesia bore the brunt of the tsunami, suffering 100,000 of the 150,000 fatalities. The world's response has been generous, but is already causing tensions

Get article background

IT SEEMED too good to be true—and it was. In the aftermath of December 26th's horror, Indonesia threw open the province of Aceh to foreign aid workers and journalists. Singaporean planes, American helicopters and Australian warships all entered what had been a highly restricted military zone. The Indonesian army even talked about suspending its offensive against the separatist rebels of the Free Aceh Movement (GAM by its Indonesian acronym). Such openness and moderation marked a break with the suspicion and secrecy of the past, and raised hopes that Susilo Bambang Yudhoyono, Indonesia's new president, would set a fresh tone for government policy on Aceh, and on security matters more broadly.

Old habits, however, die hard. As the aid effort got under way, military spokesmen announced that GAM was attempting to steal provisions and infiltrate refugee camps. Relief workers, the army said, were not safe—although none of them had expressed any concerns. When shots were fired in Banda Aceh, the provincial capital, the police immediately blamed the rebels. The army, arguing that GAM was somehow trying to take advantage of the catastrophe, delayed the truce.

At first, civilian officials played down the army's concerns. Alwi Shihab, the minister in charge of the relief effort, cast doubt on stories of rebel infiltration. An agitated soldier, rather than an insurgent, turned out to be responsible for the gunfire. Meanwhile, Mr Yudhoyono asked several foreign diplomats for their advice on how to handle Aceh—a step close to treason in the eyes of

Indonesia's more xenophobic generals.

In recent days, however, the government has started to toe the army's line. Earlier this week, it said foreigners would no longer be allowed to leave the cities of Banda Aceh and Meulaboh without a military escort. It also instructed all foreigners in the province to register with the authorities. In theory, these measures guarantee the safety of aid workers and prevent duplication in relief efforts. But the rebels insist that they will not disrupt the humanitarian work. Besides, unnecessary bureaucracy is a bigger obstacle to the relief effort than are duplication and the bedraggled guerrillas of GAM.

Mr Yudhoyono himself has said that he would like to see all foreign aid workers leave Aceh by the end of March. Underlings hint that some are not aid workers at all, and have come to the province with ulterior motives. The sooner foreign troops leave, the better, says Jusuf Kalla, the vice-president. Since the people of East Timor voted for independence from Indonesia in a UN-sponsored referendum in 1999, many Indonesians have become convinced that outsiders are plotting to dismember their country. Donors, such as Australia, which has pledged A$1 billion ($760m) in aid, were hoping that generosity would dispel such notions (see article). So far, it hasn't.

The government seems more relaxed about local helpers. Extremist Muslim outfits, such as the Islam Defenders Front and the Indonesian Mujahideen Council, have set up shop in Aceh unhindered—even with official assistance, according to some reports. In the past, such groups have recruited fighters to join in sectarian conflicts in other parts of Indonesia, or mounted vigilante attacks on businesses they deem immoral, including bars and nightclubs.

In fairness, the government's prickliness over foreign aid and its forbearance in the face of radical groups reflect local public opinion. It would be politically impossible at such a time for the authorities to turn away volunteers on the grounds that they were too religious. By the same token, ordinary Indonesians bridle at the idea that their country, the fourth most populous in the world, needs to be rescued from abroad. The speaker of parliament, among other politicians, has been urging the government to show foreigners the door as soon as possible.

Yet many observers had hoped that Mr Yudhoyono would use the authority of his office to press for a less emotive approach. Indeed, some analysts wonder whether the president really supports the new regulations in Aceh, or has simply been outmanoeuvred by hardliners in the army. He is a former general himself, and has recruited a former commander of the military garrison in Aceh to his staff. On all sorts of issues, from the composition of his cabinet to overhauling the budget, he has proved less of a reformer than many imagined at the time of his election.

As it happens, the relief effort in Aceh also impinges on the budget. On January 12th, ministers and officials of the Paris Club, a group of 19 big donor countries, offered Indonesia and other victims of the tsunami an immediate moratorium on payments, while they consider other forms of debt relief. Since Indonesia is due to pay its sovereign creditors some $8.8 billion over the next two years, the impact could be enormous

Indonesia has accepted the moratorium in principle. But the details are controversial. Newspapers are already giving warning that a moratorium, rather than a write-off, could aggravate the long-term debt problem, not least by affecting the country's credit rating. In 2003 a previous government spurned similar relief on the grounds that it

compromised sovereignty. Mr Yudhoyono's team is struggling to plug the budget deficit and stop wasteful spending. A multi-billion-dollar windfall might encourage the reverse.

In any event, donors will want to be sure that the money freed up by the moratorium is actually spent on reconstruction in Aceh. But proper scrutiny seems unlikely, if the government's reluctance to grant foreigners unrestricted access to the province is anything to go by. For all its power, the tsunami does not seem to have changed some underlying attitudes in Indonesia's armed forces and officialdom. Only Mr Yudhoyono can do that.

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Indonesia and Australia

How to be a neighbour

Jan 13th 2005 | SYDNEY
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Healing old wounds and new

SINCE John Howard came to power as prime minister almost nine years ago, Australia's relations with Indonesia, its closest northern neighbour, have been rocky. Mr Howard turned most of his attention to America, provoking suspicion in much of South-East Asia that Australia was not really interested in engagement with its own region. But Australia's swift and generous response to Indonesia's plight after the Indian Ocean tsunami suggests Mr Howard is seeking to improve what is probably Australia's most critical local relationship.

Can it work? So far the signs are good. When Mr Howard met Susilo Bambang Yudhoyono, Indonesia's president, in Jakarta on January 5th, he promised A$1 billion ($760m) to Indonesia, half in direct aid, the rest in low-interest loans. It was the biggest aid package in Australia's history, and came on top of A$60m of Australian government help for other countries hit by the tsunami.

Australia has sent almost 1,000 troops and army engineers to the shattered province of Aceh. This could cause problems once their humanitarian operation is up and running. The presence of an Australian military contingent, even an unarmed one such as this, in a province where rebels have been fighting for almost 30 years to break free from the government in Jakarta, is bound to remind some Indonesians of the tensions that have marred relations in the past.

Chief among these was East Timor. Indonesia's government bitterly resented the part Australia played in bringing about East Timor's independence in 1999 after almost a quarter of a century of Indonesian occupation. As the world's most populous Muslim country, Indonesia has since looked askance at Mr Howard's strong support for America in the Iraq war. Mr Howard's apparent willingness for Australia to be seen as America's “deputy sheriff” in South-East Asia has not helped. Nor has Australia's decision to buy cruise missiles, or Mr Howard's remarks about the possibility of launching pre-emptive strikes against terrorists in Asia. Many Indonesians took this to be directed at them.

For all that, relations between the two countries may be better than they look. Much of Mr Howard's posturing has been for domestic political consumption, designed to make his government look strong in the face of regional terrorism, especially the Bali bombing of 2002, in which so many Australians were killed. The perpetrators of that atrocity were tracked down after close co-operation between Indonesian and Australian police, thereby proving that neighbourliness was possible in spite of the old suspicions. Australia's conspicuous generosity in the aftermath of the tsunami should underline that message.

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Japan

Liberals in the lead

Jan 13th 2005 | TOKYO
From The Economist print edition

This year's local elections will show how much Japan is really changing

IF ALL politics is local, then 2005 could be a big year politically for Japan. Throughout the year, 136 elections will be held in prefectures and big cities, along with more than 400 local ones in smaller towns. Local politicians have already been gaining prominence in recent years, with independent-minded governors such as Masayasu Kitagawa in Mie, Yasuo Tanaka in Nagano and Shintaro Ishihara in Tokyo grabbing headlines and upstaging national politicians and officials. If these trends continue in 2005, that will be a good indicator of the prospects for reform.

Naturally, there are some big national issues to watch this year. Lawmakers and bureaucrats will do battle over tax increases, rising social-security costs and the post-office privatisation scheme of Junichiro Koizumi, the prime minister. All eyes will also be on the national economy, which has been slowing after an impressive rebound over the past couple of years. And with Mr Koizumi due to reach his term limit in 2006, the jockeying to succeed him will begin this year. Yet the growing competitiveness of local politics, and the increasing tendency of local leaders to start national debates, could give this year's local elections a big role in the battle to form Japan's next government.

For starters, they should allow the main opposition party, the Democratic Party of Japan, to hone its message ahead of the next general elections, due by 2007. The DPJ has gained ground over the past couple of years, ushering in real two-party competition for the first time in decades and moving within striking distance of wresting power away from the dominant Liberal Democratic Party (LDP). As a result, the DPJ has started to abandon the traditional opposition practice of backing the same candidates as the ruling party in local contests. When the LDP was the only game in town, the best opposition parties could hope for at the local level was a share of the spoils. Now, the DPJ sees those local polls as battles in a bigger war.

The DPJ lacks strong candidates in rural areas, however, especially in conservative LDP strongholds in the south and west. One strategy that might help, says Eisuke Sakakibara—a prominent former official and now a leading Koizumi detractor—is to exploit schisms in the LDP when backing candidates, even those who become independents rather than join the DPJ fold. In Miyakonojo, a city in the southern prefecture of Miyazaki, the 35-year-old son of a senior LDP politician ran as an independent recently and won after his father fell out with the ruling party. The DPJ, says Mr Sakakibara, can find good rural candidates by exploiting such rifts.

If it can turn in more good showings this year, both in the local polls and in a handful of by-elections for seats in parliament, the DPJ might even convince the LDP's coalition partner, New Komeito, that the LDP's days are numbered. New Komeito already holds the balance of power in Japan's upper house, and if its supporters stop backing LDP candidates in the cities, the LDP could quickly lose control of the lower one. The local route has many more stops than the express, but it could be taking Japan in an interesting direction.

China

The bulldozing of Silk Alley

Jan 13th 2005 | BEIJING
From The Economist print edition

Why a Beijing landmark vanished

AFP

Everything must go

UNTIL last week, no foreign tourist's trip to Beijing was complete without a trip to the Great Wall, a tour of the Forbidden City and a wander through Silk Alley, where knock-offs of famous brands of clothing and watches could be bought for a small fraction of the price of the real thing. Never mind that similar fakes could be bought for even less elsewhere in the city. Silk Alley traders could mark up their prices because their market had become such a magnet for what a local-government website sweepingly called “high nosed, yellow haired foreigners”.

Now, ironically, it is the traders who claim they are being cheated and their brand name violated. On January 6th, the 20-year-old landmark was bulldozed after police moved away protesting merchants. The local government said the stalls were a fire hazard and erected illegally. Many traders say they believe the real motive was to eliminate competition for a multi-storey indoor-market complex which is soon to be opened next to the alley in Beijing's main diplomatic quarter. Traders have been offered preferential terms to move into the new building, but so far less than a quarter of them have taken up the offer. Most say the rents, which are several times higher than they pay now, are unaffordable.

Particularly galling to the merchants is that the new building has taken the name of the old market, Xiushui. The developer claims to have registered the right to use the name, but traders say it had no right to do so given that it was they who built up the Xiushui brand. The merchants say they received no compensation for being forced to close down, and had little warning. Final notice was only given a couple of weeks beforehand. More than 100 stallholders this week

petitioned the central government to uphold their complaints. Many say they now face unemployment.

Jiang Zezhong of the Capital University of Economics and Business in Beijing says Silk Alley's demise is a sign that the heyday of family-run businesses, or *getihu*, is over. Silk Alley evolved thanks to the Communist Party's decision in the early 1980s to encourage the development of *getihu* in order to provide work for the unemployed. These were allowed to hire no more than seven people. Any more and they would be classified as private businesses, which remained banned until later in the decade.

As the production of fakes boomed in China in the 1990s, so did Silk Alley's business. The traders enjoyed a privileged position. Only *getihu* with Beijing residence permits could operate in Silk Alley. They could make handsome profits by renting their stalls to out-of-town traders as demand for limited space in the alley grew. The nearby American embassy complained about copyright violations, but only a handful of traders were fined each year for selling fakes. For the government, meanwhile, the market was a cash cow. In 2001 its 400 stallholders paid $980,000 in fees and taxes. The following year they paid $1.23m.

So why close the market down? Mr Jiang, who along with a handful of other scholars has championed the traders' cause, sees Silk Alley's fate as symptomatic of a trend in Chinese cities towards closing down open-air markets and moving them into impressive new structures. He says that the needs of urban family businesses have become less important to officials as they seek to curry favour with large private firms. The *getihu* are also being subjected to increasingly heavy fees by rapacious local authorities. According to Mr Jiang, such treatment is part of the reason for the decline in the number of officially registered *getihu* in China from 62m in 1999 to 46m in 2003. Some scholars, however, argue that the real explanation is the reclassification of some *getihu* as private businesses, and a change to the way the statistics are compiled that eliminated the counting of registered but non-functioning *getihu*.

The government says that fakes will be strictly banned in the new Silk Alley building. For all their legitimate outrage, this may be a big reason why the old market's traders are reluctant to move.

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Pakistan

Taliban welcome

Jan 13th 2005 | QUETTA
From The Economist print edition

Afghanistan's deposed clerics in exile

Get article background

BOR JAN, a wispy-bearded Afghan, whipped a scrap of paper from a pocket of his baggy trousers. “Find any Muslims who are friends of the infidel and kill them,” he read aloud. Across the nearby border with Afghanistan, America has dispatched soldiers to deter Mr Jan and his Taliban fellows from carrying out their orders. But in Quetta, capital of Baluchistan, a sprawling western province, Mr Jan could at least rant at his leisure.

Nothing irks America's men in Afghanistan more than their enemy's propensity to flee into Pakistan, there to rest and re-arm, seemingly at will. Although—at the top level, at least—a firm American ally since the September 11th attacks, Pakistan refuses to allow American boots on its soil. It has maintained that it can deal with any Taliban seeking refuge in its territory—which after all was where the movement was begun.

The Taliban were formed in the early 1990s, by clerics of the ferociously devout Pushtun, a tribe of both Pakistan and Afghanistan. The black-turbaned clerics' aim was to end Afghanistan's civil war, which they achieved with help from Pakistan's Inter Services Intelligence (ISI) agency. By 1996, the Taliban had seized Kabul. In 2001, with America's bombers circling Afghanistan, Pakistan abruptly abandoned its former friends and professed itself an enemy of terror. But quite how abandoned were they really?

Of the thousands of Taliban members who fled into Pakistan from the bombing and subsequent

occupation of Afghanistan, no notable individual was arrested. Quetta's deputy police chief, Muhammad Riaz, explains this with a shrug: “You cannot arrest everyone wearing a turban.” No, but you might arrest one or two.

A Taliban commander captured in Afghanistan last year said he was travelling on his way back from a war council in Quetta, where he had collected a cache of ammunition for the insurrection back home. His satellite telephone showed evidence of contact with several other Taliban leaders; all of them had Pakistani telephone numbers.

Pakistan received America's plaudits—and cash—last year for its continuing campaign against terrorists. Having survived two assassination attempts at the end of 2003, Pervez Musharraf, the country's leader, has been cracking down on al-Qaeda's remnants, resulting in several important captures and kills. He has also waged a small war in the tribal area of Waziristan, pitting 70,000 soldiers against tribesmen he accuses of sheltering foreign Islamic militant fighters. According to official figures, the army has killed 300 militants in Waziristan, more than 100 of them foreigners, and suffered over 170 casualties. Against the Taliban, however, Pakistan is playing a murkier sort of game.

In Quetta, Mr Jan is not alone in boasting openly of his Taliban membership. Many young militants were recruited for the movement in the city's teeming mosques and Islamic schools; in Arabic, *taliban* means students. In the city's bazaars, a rich array of *jihadi* paraphernalia is on display. From the Talib Speeches Centre, audiotaped racist bilge can be acquired for 50 cents. A hawker sells posters celebrating the face of Osama bin Laden, and bumper stickers recommending the delights of martyrdom.

What do such displays mean? Not, perhaps, that the Taliban are thriving still. In October, they failed to disrupt Afghanistan's first democratic elections in a quarter of a century, as they had threatened. Afghanistan's new government has since offered an amnesty to Taliban foot-soldiers. But their radical mentors, still supported by sympathisers within the Pakistani establishment, will take more than a bombing campaign to root out.

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Kazakhstan

Waiting for the next dominoes

Jan 13th 2005 | ALMATY
From The Economist print edition

Will Kazakhstan go the way of Georgia and Ukraine?

THE people of Georgia took the lead with their peaceful “rose revolution” in 2003, which felled President Edward Shevardnadze in the aftermath of a rigged election. Ukrainians followed suit with last month's “orange revolution”, after a dubious presidential vote appeared to cheat Victor Yushchenko of victory. The authoritarian leaders of ex-Soviet Central Asia, where free and fair elections are almost unknown, would be less than human if they were not now worried about a domino effect.

Recent events in Ukraine have indeed been an inspiration for the opposition in Kazakhstan, more so than those in much smaller Georgia. Leaders of all three opposition parties—Democratic Choice of Kazakhstan (DCK), Ak Zhol and the Communists—rushed to Kiev, Ukraine's capital, to soak up the heady atmosphere of the demonstrations and to have their photos taken alongside Mr Yushchenko.

All this seems to have thoroughly unnerved the Kazakhstani authorities. Having ruled the country with an iron hand since the last days of the Soviet era, President Nursultan Nazarbaev has already declared his intention to run for another seven-year term in the next presidential elections, which are scheduled for January 2006. Once it became clear that Mr Yushchenko had indeed won Ukraine's rerun, the president's men pounced.

On January 6th, a court in Almaty ordered the closure of DCK on charges of “inciting social tension” and “political extremism”. International human-rights organisations have strongly condemned the decision. Ostensibly, it was based on a statement the DCK made at its party congress on December 11th, saying that the conduct of the parliamentary elections of September 2004, widely criticised in the West, had left no hope for political reform in Kazakhstan. The party went on to deny the legitimacy of the existing government and call for protests and civil disobedience.

That sort of robust declaration by Kazakhstani opposition parties is not uncommon. But the brave talk is seldom followed by action. This is a country that has no real tradition of street protest. And the need to ask the authorities for permission—usually denied—to hold any sort of demonstration whatsoever has so far been a strong enough deterrent to hold big protests at bay.

On top of this, Kazakhstan does not suffer from the ethnic divisions and poverty that conspired to make Georgia and Ukraine so volatile. Oil revenues have produced five years of significant economic growth and soothed discontent. In these circumstances, the government's decision to close down DCK looks like a panicky over-reaction—exactly the sort of measure that can sometimes cause the very trouble it seeks to avert.

Iraq

It'll soon be time, at last, to vote

Jan 13th 2005 | BAGHDAD
From The Economist print edition

Reuters

Though the election will be boycotted by many or even most Sunni Arabs, it should still offer Kurds and Shia Arabs a rare chance to choose their own leaders

Get article background

AT LEAST in those parts of Iraq where the insurgents do not dominate, the election campaign has begun in earnest. Posters plaster the walls, at any rate in the Shia and Kurdish areas that contain a good three-quarters of the country's people. And though full lists of candidates' names are hard to find—and in some cases have yet to be drawn up (see our table)—Iraqis are gradually becoming aware of the main choices of party alliances and leaders on offer when some 5,500 polling stations open on January 30th. It is increasingly likely that turnout in the Sunni Arab areas, especially in the four out of 18 provinces most afflicted by the insurgency, will be dismally low. Nonetheless, most Kurds (who make up a fifth of the people) and Shias (some three-fifths) sound determined to vote.

Who's who?

Party/list*	Main component	Leading personalities	Platform
United Iraqi Alliance	Supreme Council for the Islamic Revolution in Iraq (SCIRI)	*Abdul Aziz al-Hakim;* *Adel Abd al-Mahdi*, interim finance minister	Most Iraqis call this group simply "the Shia house" or "the clerics' list": it professes a special relationship with Grand Ayatollah Ali al-Sistani, Iraq's most influencial Shia clergyman, who helped draw up the list but has not formally blessed it. Some opponents claim it was made in Iran; some supporters, however, such as Mr Chalabi, are secular-minded
	Dawa (Call) Party	*Ibrahim al-Jaafari*	
	Iraqi National Congress	*Ahmed Chalabi*	
	Independent personalities	*Hussein Shahristani*, a nuclear scientist	
The Iraqi List	Iraqi National Accord	*Iyad Allawi*, interim prime minister, a Shia	"A strong leadership, a safe nation"; promotes personality of Mr Allawi, wants stronger armed forces, stresses law and order; mainly Shia-led but secular-minded; seeks support in Sunni tribal areas
	Independents	*Fallah Naqib*, interior minister, a Sunni; *Thamer al-Ghadhban*, oil minister, a Sunni; *Hussein al-Sadr*, moderate Shia cleric; *Wael Abd al-Latif*, former governor of Basra	
Iraqis		*Ghazi al-Yawer*, interim president, a leader of the large, mainly Sunni, Shammar tribe	Similar outlook to Mr Allawi's Iraqi List, with which it could team up after the election
		Hazem al-Shaalan, defence minister, a Shia	
Kurdistan Alliance	Kurdish Democratic Party	*Massoud Barzani*	Promotes Kurdish national cause, secularism, autonomy for the north, and claims the disputed city of Kirkuk as Kurdish. Is sure to win in the three Kurdish provinces in the north
	Patriotic Union of Kurdistan	*Jalal Talabani*	
	At least six smaller northern parties		
Union of the People	Communist Party	*Hamid Moussa*	Strongly secular; stresses justice and welfare. Iraq's oldest party, the Communists have a small but dedicated following, persecuted by Saddam Hussein's Baath Party
	A smaller left-wing party		
Alliance of Independent Democrats	Iraqi Independent Democrats	*Adnan Pachachi*, former foreign minister, Sunni elder statesman	Secular and liberal, led by returned exiles
National Democratic Party		*Nasir al-Chaderchi*	Secular and liberal
National Democratic Alliance		*Samir al-Sumaidai*	Secular and liberal
Independent Nationalist Cadres and Elites		*Fathallah Ismail*, a journalist who backs radical Shia cleric Muqtada al-Sadr	Support strongest in east Baghdad slum known as Sadr City. Mr Sadr has yet to endorse it; if he does, its chances should soar
Iraqi Republican Alliance		*Saad al-Janabi*, Sunni businessman with large tribal backing	Fiercely anti-American and Sunni Arab nationalist; demands immediate removal of American troops, a strong centralised state, and trials of Iraqis for "errors" committed in post-Saddam transition; rich
Constitutional Monarchy		*Sharif Ali bin Hussein*, cousin of last king	Wants a constitutional monarchy; nostalgia for past era
Iraqi Hashemite Alliance		*Sharif Maamoun Abd al-Rahman al-Naisan*	Rival monarchist party
Movement of Free Officers and Civilians		*Najib al-Salhi*	Harks back to ideas of Abdul Karim Qasim, who ruled Iraq from 1958 to 1963: popular with Shia, he overthrew monarchy but was in turn overthrown and killed by the Baath
Iraqi Islamic Party		*Mohsen Abdel Hamid*	Descendant of Iraqi branch of pan-Islamic Muslim Brotherhood, post-Saddam Iraq's most prominent Sunni Arab party; no longer running after calls for election postponement were ignored
Religious and ethnic-minority lists	Alliance of the Turkomen Front of Iraq		All Turkomen parties promote rights of 500,000-odd Turkomen (ethnic kin of Turks, claiming 3m in Iraq), mainly in Kurdish north
	National Turkomen Movement	*Hossam Eddin Ali Wali*	
	Turkomen Brotherhood Party Iraq	*Walid Mohammed Salah al-Sharaka*	
	Alliance of the Two Rivers		Christian
	National List of the Two Rivers		Christian
	National Assyrian Alliance	*Odisho Milko Kurkis*	Christian
	Yazidi Movement for Reform and Progress	*Amin Farhan Jijo*	Supported mainly by Kurds who follow a religion said to be related to Mithraism, an ancient Roman mystery cult

Source: *The Economist*

*84 parties and lists, along with 27 independents, have registered

Some groups, most notably the Iraqi List headed by the interim prime minister, Iyad Allawi, are zealously soliciting votes, through the media, at press conferences and—most expensively—on pan-Arab satellite TV channels. At a recent Iraqi List "seminar" for (mainly Arab) journalists in a Baghdad suburb, activists for Mr Allawi's group handed each reporter who was kind enough to attend a one-hundred-dollar note in appreciation.

Other prominent groups are claiming to have the blessing of the country's top religious leaders. In particular, the United Iraqi Alliance, a broad coalition of Shia parties, most of them Islamist-inclined, has covered Baghdad's buildings with portraits of well-known ayatollahs alongside its logo. And a daring few candidates are braving the pavement, such as Fathallah Ismail, a disciple of the firebrand cleric Muqtada al-Sadr, who charges headlong across the bustling crossroads of north-east Baghdad's Shia slums, handing out cards that puff his Nationalist Independent Cadres and Elites.

The Sunni Arab insurrection, which shows no sign of abating, has made campaigning in large parts of Iraq too dangerous. Even Mr Allawi now admits that people in “some pockets” of the country will not be able to vote. Fearful that their candidates will be assassinated, most of the main groups are not disclosing most of the names on their slates, beyond a few well-known figures. So voters are unsure of what many—maybe most—of the 84 parties and alliances and 27 individuals on the ballot actually stand for and, in many cases, who is running for them.

In the most violent regions, Iraqis may wait until election day before deciding whether to vote at all. More than 1m Iraqi expatriates in 14 countries, including the United States, various European states, Iran, and across the Arab world, have also been allowed to vote in special polling stations abroad. In Iraq, the Americans are hoping for a turnout of more than half of the 15m-odd eligible voters. Anything bigger than that will be deemed a success.

The outcome is highly unpredictable. The nearest thing to a certainty is that the Kurdistan Alliance, a joint list combining the Kurds' two main parties and a clutch of minnows, will sweep the Kurdish north-east—and may well give the Kurds a disproportionate number of seats since their turnout, in the safest part of Iraq, is likely to be the highest. Parties representing Iraq's Christians, Turkomen (ethnic Turks), Yazidis (who follow a creed close to a Roman-era cult) and other minorities may pick up a few seats: all a party needs, to win a seat in the 275-strong assembly, is 1/275th of the total vote.

The main battle, however, is being waged between the Alliance (widely known as “the Shia house” or “the clerics' list”) and Mr Allawi's lot. A few weeks ago, it was assumed that the Alliance would gobble up most of the Shia vote. Grand Ayatollah Ali al-Sistani, Iraq's most influential Shia cleric, had played a notable part in creating the Alliance. Mr Allawi's allies, however, point out that Mr Sistani has not explicitly endorsed it, and they have fiercely attacked the Alliance's adherents for—allegedly—telling Shia voters that they have a religious obligation to vote for it.

By contrast, campaigners for Mr Allawi's Iraqi List are promoting his personality, lauding a reputation for toughness that is said to appeal to Iraqis fed up with the violence and strife. This seems to be going down better than expected. Preliminary results of an opinion poll in Baghdad and the Shia south found that 22% may vote for Mr Allawi's group versus 27% for the Alliance. Mr Allawi did even better as an individual, polling at 35% against 11% for his closest competitor, Ibrahim al-Jaafari of the Dawa Party, probably the Alliance's strongest component.

If most Sunnis in rebellious areas seem highly unlikely to vote, the prospect for places such as Sadr City, home to some 1m poor Shias in eastern Baghdad, where followers of Mr Sadr fought fiercely against the Americans last year, is still in doubt. In any event, Mr Sadr's movement is split between pragmatists who want to win a modicum of power by co-operating with the new order and a more militant wing that prefers messianic declarations and last stands. Mr Sadr himself has yet to endorse any list, and many of his followers say they will not vote unless their lender takes a stand.

It will be hard, if not impossible, to fathom the Sunni Arabs' electoral wishes. The most prominent Sunni Arab partner in Mr Allawi's government, the Iraqi Islamic Party, pulled out of the race after calling in vain for a delay. This leaves the field to liberal Sunnis like Adnan Pachachi of the Iraqi

Independent Democrats, who may pick up votes from secular-leaning Iraqis in parts of Baghdad where it is safe enough to go to the polls, and to Sunnis with strong tribal links, such as those of the interim president, Ghazi al-Yawer, and his powerful Shammar tribe. A rich businessman with tribal ties in western Iraq, Saad al-Janabi, is running on an anti-occupation platform that seems designed to win votes from sympathisers of the insurgents.

An unSunni outlook

So Mr Allawi, the Kurds and the Alliance look likely to split the lion's share of seats. Until a few weeks ago, Mr Allawi seemed to have a good chance of staying on as prime minister, largely because he lacked a base of his own and seemed not to threaten the main Kurdish and Islamist-minded Shia parties. But now that he may be emerging as a force in his own right, the Alliance may feel it should press for a prime ministerial candidate of its own: perhaps Hussein Shahristani, a nuclear scientist who is close to Mr Sistani, or the finance minister, Adel Abd al-Mahdi.

Iraq's Arab, Turkish and Iranian neighbours all seem minded to give the emerging assembly and the government it endorses a chance to establish itself. Though the UN has played but a small part in the proceedings, a better-than-expected election might encourage the international body to become more involved in Iraq's next step towards building a democracy.

Most crucial of all, however, is the degree to which Iraqis have the courage to vote. If they do in large numbers, despite the expected Sunni stay-away, that might give the new order a sense of legitimacy it has hitherto woefully lacked.

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Iraq's security forces

No exit strategy

Jan 13th 2005 | BAGHDAD AND TAL AFAR
From The Economist print edition

Few of the new Iraqi forces seem willing to stand and fight

Get article background

AFP

America's friends, for the moment

COLONEL ROBERT BROWN, of the American army, was almost killed in northern Iraqi city of Mosul last year—but not by insurgents. His error was to have put Iraqi police commandos in the rear of his patrol. When the patrol was ambushed, the commandos returned fire into the backs of their American allies. “If you're working with commandos,” the colonel advised, “be sure you know where they are.”

Yet the commandos, who currently number around 4,000 retrained fighters of the old regime, are probably the best of the Iraqi Security Forces (ISF), along with a similar number in Iraq's revamped regular army. Wild they may be, but at least they seem willing to fight. The same is not true of the regular police, who have almost always run away as the insurgency billowed across the country over the past year. Nor has the Iraqi National Guard (ING), a militia modelled on America's National Guard, distinguished itself: in Tal Afar, a rough town in the northern province of Ninewah, up to two-thirds of the ING have deserted and the remainder will hardly work alongside American troops. In Iraq's more violent parts, said a report released by the State Department last week, many of the ISF have been “rendered ineffective”. Or worse: last month, a suicide bomber wearing an ING uniform killed 22 people at an American base in Mosul.

This ineffectiveness is in part testimony to the insurgents' effectiveness. Midway through last year, they began increasingly to target the ISF in preference to America's hardier troops. Over 100 have been killed this year—about four times the number of slain Americans. “Many of my men have been intimidated, some have been killed,” says the ING's commander in Tal Afar. “Of course, they're more concerned to look after their families than to fight.”

Yet even these horrors fail to explain why, nearly two years after the invasion of Iraq, so few of the country's estimated 150,000 ISF, including 50,000 policemen, seem prepared to stand and fight. This week Iyad Allawi, Iraq's interim leader, announced plans for an additional 50,000 Iraqi troops to be trained, without suggesting how they might be persuaded to perform any better. The ISF are supposed to be America's “exit strategy”, after all, replacing American troops on Iraq's deadly streets. This week, America dispatched a trusted retired general, Gary Luck, to Iraq, to review the conduct of American and Iraqi forces.

Part of the explanation, as in so many areas where policy in Iraq has failed, lies in the lack of a post-war plan. In May 2003, the Americans formally disbanded the country's old army—some

400,000 men, including 12,000 generals—with no plan to replace it. After several false starts, unrealistic and increasingly desperate hopes were held for the first ISF to come on-stream. The first army battalion was ordered to the front of an assault on Fallujah last April, and promptly mutinied.

A steadier approach to training the ISF was introduced midway through last year, after the appointment of Lieut-General David Petraeus, an ebullient American, to the helm. Recognising that the ING have been terrorised to paralysis in their home towns, he has started deploying them to neighbouring towns. Similarly, he has concentrated efforts on training mobile special forces, such as the commandos, recruited largely from the disbanded Republican Guard, and other elite units that served under Saddam Hussein.

The commandos' leader, General Adnan Thabit Maher, says he had despaired of the Americans' policy of excluding members of the tougher units of the old army from the new ISF. “We realised we had to recruit people already trained to fight terrorists, and unless we did this they would join the terrorists themselves.”

The trouble is, only 10,000 or so Iraqis are well-trained and determined enough to take the insurgents on, while Iraq's head of intelligence says the number of hard-core insurgent may be as high as 40,000. An American colonel recently enthused about the insurgents' performance. “They were organised and committed,” he said. “On a par with the commandos.”

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Israel and the Palestinians

And so to work

Jan 13th 2005 | ABU DIS AND JERUSALEM
From The Economist print edition

A new Palestinian leader eyes a new Israeli government

Get article background

MAHMOUD ABBAS shook his greying head: no, he said, he didn't plan to vote in the Palestinian presidential election. What was the point? It was obvious who would win; and in any case, nobody could be a good leader "because Israel won't let him". Mr Abbas, a street vendor of sweet, milky *sahleb* in Abu Dis, across the valley from Jerusalem, reckoned that his namesake, Yasser Arafat's former right-hand man, would "succeed for a bit", but then he would run into problems.

A lot of Palestinians must feel the same. On the one hand, the election on January 9th was something to make them proud and other Arabs envious. There was a real choice of candidates—Mustafa Barghouti, an independent reformist, got a decent 20% against 62% for Mahmoud Abbas (also known as Abu Mazen)—and the voting was generally clean and peaceful. The next day the Egyptian Organisation for Human Rights called for Egypt to change its system in which parliament, dominated by the ruling party, gives voters just one candidate to approve. "The Palestinian people chose their president," Hussein Abdel Razeq, speaking for the outfit, said pointedly.

But the turnout was not as high as at first claimed: 71% of registered voters, but fewer than half of the estimated 1.7m-1.8m eligible voters, since a third or more of them did not register. The elections commission changed the rules part-way through the day to make it easier for the unregistered to vote, and extended voting by two hours, claiming that Israeli checkpoints were stopping people from getting through; but European Union observers reported that, for the most part, voters had "sufficient freedom of movement".

Apathy, then, may have deflated Mr Abbas's victory. But he remains everyone's best hope for restarting a peace process. Ariel Sharon, Israel's prime minister, who had suspended talks with Arafat, called Mr Abbas to congratulate him. They may meet next week, perhaps to discuss proposals to let the Palestinian Authority take over security in selected towns.

That, of course, is Israel's way of testing Mr Abbas. It wants him to force militants, both in his own party and in the Islamist opposition, to give up their weapons. The Palestinian national security adviser, Jibril Rajoub, has resigned, which may signal Mr Abbas's intention to reorganise the dozen competing Palestinian security services into a smaller, more manageable group. But though he condemns violence, he also knows the limits of his mandate, and would much rather persuade militants to lay down their arms voluntarily.

Spokesmen for some armed groups have said since the election that they are willing to give him a chance. But their price will be high. Hamas, the main Islamic group, which enjoys around 20% support among Palestinians, wants Mr Abbas first to concentrate not on peace talks but on ending corruption in the Palestinian Authority and creating proper institutions such as an independent

judiciary, says Sheikh Hassan Yusef, its spokesman in Ramallah. Hamas also wants Israel to stop targeted assassinations and release a lot of the 7,000-plus prisoners it holds, before talks are even an option. Similar demands come from militants in Mr Abbas's own Fatah party—chief among them Marwan Barghouti, whose laundry list of conditions for not running in the election (which he would probably have won, even from his Israeli jail cell) included an assurance by Mr Abbas that he would not renounce the principle of armed struggle.

Egypt plans to host a conference at the beginning of March to help the factions reach a truce; it does not want Palestinian Islamic radicals, the political descendants of Egyptian ones, taking control of the Gaza strip, on the Egyptian border, any more than Israel does. But if they do agree to a ceasefire, it will hold only if Mr Abbas can show that he is getting something substantial from Israel in return. And while Israel may make token concessions on autonomy, freedom of movement and the release of prisoners, it looks unlikely to get to the nub of an actual peace deal until after it completes its planned disengagement from Gaza and a small part of the West Bank later this year. Mr Sharon's refusal to talk turkey before then will only cement the widespread belief that he has no intention of disengaging any further.

If, indeed, he can do it at all. This week what the Israeli press has dubbed “the disengagement government” began work. It is Mr Sharon's third coalition since being elected in 2001: a dysfunctional hybrid of his Likud party, a third of which opposes the disengagement, with Labour, which supports it but for reasons possibly different from Mr Sharon's (it wants it to be only a first step), and the United Torah Judaism party, which is in it purely for the money (for religious education).

This shaky coalition has so far scraped through two crucial votes, on its formation and, this week, on the budget's first reading. But Mr Sharon will frequently have to cadge opposition votes to balance the Likud rebels—effectively, making coalitions with the coalition—to keep his government whole and the Gaza pullout on track. That will leave him little time even to think about what happens after it.

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Zimbabwe

Divided we rule

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From The Economist print edition

Dissent grows within the ruling party as it prepares to steal another election

Get article background

AP

Gloomy Mugshot

WITH a general election due by late March, President Robert Mugabe's Zanu-PF party is in trouble. If Zimbabweans could vote freely, they would kick it out of office. Against heavy odds, the opposition nearly won the last poll, five years ago. Now the country is a lot poorer, hungrier, more divided and violent. Newspapers this week reported that maizemeal, the staple food, had run out. The next harvest will be grim, thanks to a dearth of seed and fertiliser in the soil. Mr Mugabe has become unpopular even in the rural areas where his promise of land and food handouts retained at least a residue of support, though few Zimbabweans—wherever they may be—risk badmouthing him in public, for fear of arrest by secret police for making threats “against the state”.

Mr Mugabe usually responds to critics by getting thugs to beat them up. The so-called Chipangano gang in Harare, the capital, breaks up opposition rallies, smashes windows and punches, kicks and stabs anyone who seems loth to cheer the president. Campaigners for the Movement for Democratic Change (MDC), the main opposition, say that last year was quieter than the one before, but at least half a dozen of its supporters were murdered by gangsters, while seven of its MPs and hundreds of followers were beaten, abducted, raped or tortured.

But it may be getting harder for Mr Mugabe to use such tactics. First, he wants to persuade his fellow southern African leaders that the coming election will be fair; last year in Mauritius they all agreed that Zimbabwe should uphold certain electoral standards. On this score, he particularly needs to placate South Africa's president, Thabo Mbeki, who has given him unstinting moral support but now, in return, wants Mr Mugabe to treat the opposition rather better.

Mr Mugabe's second problem is disunity in his own party. This week he told a crowd of placard-waving protesters in Harare that “the party is not dead, it is standing strong”. But in the past few months, vicious infighting has broken out, mainly between candidates (and their coteries) vying to succeed the president, who turns 81 next month. A faction dubbed the Young Turks last month tried to push forward parliament's speaker, Emmerson Mnangagwa, a former security-services head, as vice-president and leader-in-waiting. Mr Mugabe, who had other ideas, responded ruthlessly, sparking several rows.

The information minister, Jonathan Moyo, who has spent the past few years singing Mr Mugabe's praises to the rest of the world, was identified as a Young Turk ringleader. For his pains, he has been sacked from the party's politburo and told not to stand in the March election. Other Young

Turks, including Zimbabwe's ambassador to Mozambique and a top Zanu-PF-connected businessman, have been accused of “spying for a foreign power”.

Mr Mugabe instead tapped an old ally, Joyce Mujuru (“Comrade Spillblood” in her days as a guerrilla) as a vice-president and heir apparent. This prompted other party factions to accuse the president of being a high-handed tribalist. Mrs Mujuru (whose husband was head of the armed forces) is from Mr Mugabe's own Zezeru sub-group of Zimbabwe's dominant Shona people, as is Joseph Msika, the other (longer-serving) vice-president, and many others in plum jobs. Zimbabweans hailing from the other two biggest Shona sub-groups, the Karanga and the Manyika, may now join the long-disaffected Ndebele in the south-west, as well as the vast majority of Zimbabwe's dwindling number of whites (perhaps now down to 20,000), in their hostility to Mr Mugabe.

Does the MDC have a chance of winning? After much hesitation, it now says it will contest the poll in March, provided that Mr Mugabe reduces violence and lets foreign observers and journalists monitor the proceedings. But the opposition is fractious too. Many MDC backers complain that Morgan Tsvangirai, their leader, is indecisive. Many pro-MDC Zimbabweans have emigrated; constituencies have been redrawn to favour Zanu-PF; new laws make opposition rallies and campaigns all but illegal. Even if the MDC does well, says Welshman Ncube, one of its leaders, Mr Mugabe will always play another trick to keep it out of power. The voters' roll, he says, includes names of 500,000-odd dead people or fake names that could yet be used to fiddle the result.

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France

Jacques Chirac and the politics of the past

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The perpetual president and his perennial promises

Get article background

WITH all the vigour and resolve of the freshly elected, President Jacques Chirac kicked off the annual ritual of new year speeches on fine form. “France must be on the offensive,” he declared. “We must act with determination for strong and lasting growth”; and “we must act urgently” to combat unemployment and “reinforce our social cohesion”. Just the sort of talk needed to inspire the team and to set France up “for the next ten years”, as Mr Chirac added. Except that this president is not freshly elected at all. Next May, he will mark ten years in power, the longest of any current leader among G8 countries. And the longer he serves, the more his promises sound wearily familiar—and thin.

Recall Mr Chirac's first pledges. “I will engage all my force to restore the cohesion of France,” he promised at his inauguration in 1995. “Employment will be my preoccupation at all times.” During the campaign he deplored the country's “social fracture”, promised to make “combating unemployment an absolute priority”, and vowed to restore “healthy and lasting growth”. In short, he made much the same promises that he is making now.

Yet ten years on, French unemployment still nudges 10%, barely below the rate of 11.4% that he inherited. Economic growth, at a yearly rate of 1.9% in the third quarter of 2004, is little faster than 1.8% in 1995. Public finances remain squeezed; the “social fracture” still preoccupies France. Little wonder that Mr Chirac is not planning any grand ceremony to celebrate his tenth anniversary.

To be fair, the centre-right Mr Chirac has spent half his time in office with a left-wing government, with which he has often disagreed. Lionel Jospin was the Socialist prime minister in the years of cohabitation, in 1997-2002. That was when such Socialist policies as the 35-hour week, which impeded job creation, came in. Yet it still leaves Mr Chirac's five other years. Why does he have so little to boast about?

An attempt in 1995-97 to push through ambitious reforms, under the prime ministership of Alain Juppé, was thwarted by paralysing national strikes. Stung by that experience, the effort since 2002, under Jean-Pierre Raffarin, has been less ambitious—and so, perhaps, more successful. Partial reforms of public pensions and state health insurance have been passed, aimed at rescuing both systems from unsustainable deficits. Each was necessary, if controversial. By July, for instance, patients who wish to get full reimbursement of medical costs must register with a single family doctor, who will act as a gatekeeper to (more expensive) specialist consultants. This month they have started paying a non-refundable contribution whenever they see a doctor.

Yet these two reforms aside, the rest of the balance-sheet is uneven at best. Mr Chirac has made the 35-hour week a bit more flexible, and promises further adjustments; yet he has also promised that “the legal working week is not, and will not be, brought into question.” Payroll charges on low-paying jobs have been cut, but only as compensation for the extra cost of the 35-hour week. A central part of Mr Chirac's manifesto in 2002 was to cut income taxes by a third; so far, he has managed just 10%, and more cuts will be hard for his finance minister, Hervé Gaymard, to make, given the strained public finances.

Why does he have so little to boast about?

Nor is there much evidence of reforming ambition for the rest of Mr Chirac's term. Although his new year speeches were packed with detailed policy ideas, from the introduction of class-action lawsuits to the establishment of a state agency to promote innovation, they glossed over the two biggest drags on the economy: an over-regulated labour market, and an over-heavy state. This omission is partly due to the political calendar. With a referendum on the European Union constitution likely in June, nothing controversial can be expected beforehand. Mr Raffarin, whose tenure in his own job is uncertain, has said that painful reforms are now behind him. But the cautious policy mix also reflects Mr Chirac's view that the French model is not really broken at all.

Instead, in an unapologetic nod to a dirigiste era, he has pledged to put some €2 billion ($2.6 billion) between now and 2007 into *grands projets* of the sort that France launched in the 1970s in aerospace and energy. “Our responsibility is to launch today the Airbus or Ariane programmes of tomorrow,” he said. Ignoring the conclusions of a recent study led by Michel Camdessus, a former head of the IMF, the president considers the French statist model to be in need of fine-tuning, not a radical overhaul.

That Mr Chirac does not want to dwell too much on his ten-year anniversary must, all the same, reflect uncertainty about his achievements. His plan seems to be to keep the electorate's gaze fixed on the future, even beyond the end of his mandate. He referred twice last week to his plans “for the next ten years”. He has promised a referendum on Turkish entry into the EU “in ten to 15 years' time”. In short, this 72-year-old seems seriously to be considering running in 2007 for another five-year term—which would carry the not incidental benefit of extending his immunity from prosecution for political corruption. Whether he runs will depend first on whether he wins the referendum; and, second, on the ability of Nicolas Sarkozy, his chief rival on the right and boss of the ruling UMP party, to sustain the popularity he enjoyed until he left the government late last year.

Elections these days may be won more on promises than records. But the politics of promises is a delicate art. The longer Mr Chirac serves, the more strained the credibility of his pledges. This is

not lost on the voters. A tireless globe-trotter, he may remain popular for his foreign policy, where he is seen as a dignified defender of his country's *gloire*. But his overall popularity has slumped, says TNS-Sofrès, from an approval rating of 64% when he took office in 1995 to only 41% today. “Ten years is enough,” said an editorial in the left-leaning *Libération* this week: “And we're not going to take ten more.”

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Spain and the Basques

Ibarretxe and bust?

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A long-simmering row erupts over Basque independence plans

AFP

The Basques march past

SO FAR this month, the new year talk in Spain has been mostly of constitutional crisis. In Madrid there are dark mutterings about the disintegration of the state. The king and the bishops have pontificated on the sanctity of the constitution. And Spain's defence minister, José Bono, has issued a blunt warning that “no territory may engage in projects which violate the sovereign will of all Spaniards.”

The fuss began after the Basque parliament voted on December 30th to approve the Ibarretxe plan (named after the regional premier, Juan José Ibarretxe), which seeks to redefine relationships with Madrid and provide for a possible referendum on becoming “a free state associated with Spain”. The vote for the plan was won only after a last-minute U-turn by three deputies from Batasuna (now called Sozialista Abertzaleak), the banned political wing of the ETA terrorist group. Batasuna had said the plan did not go far enough. By changing his mind, Batasuna's leader, Arnaldo Otegi, who controls seven seats that were won when the party was legal, wrong-footed Mr Ibarretxe's own moderate Basque Nationalist Party.

To the disgust of most of his parliamentary audience, Mr Otegi justified his change of heart by reading out a letter from a fugitive ETA leader (and Batasuna deputy), José Urrutikoetxea Bengoetxea, backing the plan for a referendum. Mr Ibarretxe had pledged that he would not rely on Batasuna support to push his plan through. Spaniards are now angry that it was passed with the help of “three votes stained with blood”. Yet Mr Ibarretxe points out that both the Socialists and the People's Party (PP) have in the past used Batasuna's votes to block his budgets.

Whatever happens next, many in Madrid as well as the Basque country think the 25-year-old

statute on the regions must now change. Mr Ibarretxe has asked a parliamentary commission to negotiate a new statute, as it did in 1979. Mariano Rajoy, the PP leader, called his plan “the biggest challenge to national unity since 1978”. Even the prime minister, José Luis Rodríguez Zapatero, said it was secessionist, unconstitutional and incompatible with a Europe seeking to give up frontiers. He has ruled out government-to-government negotiations.

At first Mr Zapatero drew criticism for saying that the plan would be stopped at the ballot box, referring to Basque regional elections that are likely to be held in May. A mistake, opined an editorial in *El País*, as it “tends to favour the nationalists' aim of converting the upcoming elections into a plebiscite on the Ibarretxe plan.” The plan was to be presented to the Spanish parliament, the Cortes, at the end of this week. The PP is asking the constitutional court to overturn a parliamentary ruling allowing a debate at all; if it fails, a debate may be held in March.

Mr Ibarretxe, who also met Mr Zapatero late this week, has in the past played down the more controversial elements of his plan, promising that it does not aim at independence and that no unilateral steps would be taken. But he has now changed his tune. He wants the plan debated in the Cortes. If it fails there, as is likely, he has added a threat: “I am not putting in doubt the legitimacy of any institutions, but the will of Basque society will not be supplanted by any other will.”

Mr Zapatero has called for calm, promising that the plan will be defeated in the Cortes, and that only if Mr Ibarretxe presses ahead with an illegal referendum will it go to court. Doom-mongers talk of invoking article 155 of the constitution, dissolving the regional governments. Mr Ibarretxe has also said that there must be an ETA ceasefire before any referendum.

Mr Zapatero's woes are exacerbated by his minority government's dependence on the votes of the nationalist Catalan Republican Left (ERC) party. The ERC is threatening that, if the government says no to the Ibarretxe plan, it will withdraw support, bringing the government down. Yet some critics fear that Mr Zapatero's non-confrontational approach may embolden Catalan nationalists who want a new regional statute too. “The battle against the plan Ibarretxe is going to be long, at least a year in duration,” says the public administration minister, Jordi Sevilla.

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German political transparency

Stained glass

Jan 13th 2005 | BERLIN
From The Economist print edition

New demands for more open government

Get article background

IF THE new architecture of political Berlin were anything to go by, Germany would be a champion of open government. Glass is the construction material of choice, in ministries, in the chancellery and, above all, in the great cupola above the Reichstag. But appearances deceive. When it comes to transparency, Germany is well behind its neighbours' standards. Now parliament is at last considering a freedom of information bill. And pressure for transparency may rise after revelations that many members of parliament are paid on the side by big German companies.

German bureaucracy is still culturally wedded to official secrecy, going back to a time when officials were accountable only to the sovereign and nobody thought government agencies really worked for citizens. Germany is the only large member of the European Union that has no federal-level freedom of information act (some German states have acts of their own). When the centre-left government came to power in 1998, it duly promised to do something.

Last month, it introduced a freedom of information bill—though even this was opposed by Otto Schily, the interior minister, who thinks it might benefit not just citizens, but also such suspect groups as the Church of Scientology. The bill would bring Germany closer to international standards. Anyone, not just somebody with a legal interest, could request information from any public entity, and be entitled to an answer within a month (or two months in complex cases).

Naturally, there are exceptions—some of which, critics say, are not clearly enough defined. Information may be withheld if it could have an adverse effect on defence, public security or tax collection. Government contractors may veto disclosure of information on public procurement, ostensibly to protect trade secrets, although some critics say it is to limit competition. In America most freedom of information requests are filed by businesses wanting to know about previous public contracts.

The cause of transparency could be boosted by the cash-for-MPs scandal. This began when a prominent left-wing Christian Democrat was forced to resign from all party posts after it emerged that he was on the payroll of a utility giant, RWE. In revenge, his friends revealed that Laurenz Meyer, the party's secretary-general, was also paid by RWE. Mr Meyer quit just before Christmas. The next reports about moonlighting involved Social Democrats. Now, hardly a week passes without a federal or state MP admitting to being paid by a company. Recently a prominent Christian Democrat in the European Parliament, Elmar Brok, had to defend himself for working for Bertelsmann, a media giant.

Nobody suggests that anybody is doing anything illegal. Federal MPs, for instance, are allowed to work on the side to boost their incomes (around €7,000, or $9,000, a month), so long as they tell

the parliament's president. But only job titles and employers are published in parliamentary directories. This lack of transparency is now backfiring, as the voters learn how much is going to their MPs for so little apparent work. A debate has begun about how much more information to make public, allowing voters to decide if their MPs suffer from too great a conflict of interest. Some politicians are also arguing for full disclosure of the pay of bosses, and even—perhaps jokingly—of top editors.

Resistance to fuller disclosure will be fierce. Yet the notion that too much transparency can be dangerous is belied by the experience of other countries. It is also increasingly untenable as access to information becomes easier, thanks to the internet. Increased transparency could help with other German problems too: growing political apathy, the deteriorating quality of public services and corruption. In a country with such lousy weather, sunlight tends to be the best disinfectant.

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The Baltics and the second world war

Painful memories

Jan 13th 2005 | RIGA
From The Economist print edition

An awkward decision over commemorating a victory

Get article background

STALIN'S ghost must have smirked at the dilemma facing the three Baltic presidents. Should they accept President Vladimir Putin's invitation to join the 60th anniversary celebrations, in Moscow on May 9th, of the Soviet victory in the “Great Patriotic War” against Hitler—even though it cleared the way for the Soviet Union to occupy and oppress the Baltics for the next 45 years? Or should they stay away and risk accusations that they were soft on Nazi Germany, for which many of their citizens fought?

After hesitating for almost five months, President Vaira Vike-Freiberga of Latvia broke ranks this week to say she would go. Presidents Arnold Ruutel of Estonia and Valdas Adamkus of Lithuania said they would think a bit more, and sounded miffed by the Latvian move. Conservatives will accuse Mrs Vike-Freiberga of naively agreeing to celebrate not so much the defeat of Hitler as the triumph of Soviet power under Stalin. But she has calculated that the diplomatic cost of staying away would be higher. A no-show would let Russia claim that Latvia and the other Baltic countries were “Russophobes” who upset east-west relations and stood apart from European values.

The Baltics know that Russia will seize any chance to drive wedges between them and the rest of Europe. It resents their independence, almost 15 years after they escaped from the Soviet Union. It thinks that they and the other ex-communist countries that joined the European Union in May are scheming to make the EU more anti-Russian.

Mrs Vike-Freiberga is snubbing Russia's offer to sign a border treaty as a reward for her attendance. The important thing, she says, is that the Baltic side of history should be heard. She has published a declaration in which she blames Stalin equally with Hitler for causing the 1939-45 war, by agreeing secretly to divide Europe. And she calls on Russia to “express its regret” for the Soviet “subjugation” of central and eastern Europe.

Some hope. Russia insists that the Soviet Union was a law-abiding state that the Baltics joined by choice. Besides, Russia dodges responsibility for Soviet history—except, now you come to mention it, for the victory over Hitler.

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Chechnya

Still calling for help

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A decade after Russia's invasion, Chechnya remains battered and war-torn

AFP

NEWLY painted signs in Grozny suggest dialling the Russian emergency number 01 for help. They are part of Russia's attempt to show that normal life has returned to Chechnya. But amid the ruin and violence that afflict the city, they seem more like a cruel joke, for almost nobody has a telephone.

Over the decade since Russian troops invaded the rebellious republic in December 1994, tens of thousands of people have been killed in Chechnya. Kremlin claims that the war is over are plain wrong. This is a place where people are arrested by masked soldiers and not seen again; where rebels shoot police and soldiers in broad daylight; and where suspects blow themselves up to avoid arrest.

Nor is the horror confined to Chechnya. The war spawned the Moscow theatre siege in 2002, suicide bombings of two airliners in August and the Beslan school atrocity in September. There is every reason to expect more terrorist incidents in the future. What was once a local nuisance has drawn in Islamic radicals and extreme Russian nationalists, infected the rest of the north Caucasus and damaged Russia's international standing—as well as giving the Kremlin an excuse to cement its authoritarian control.

When President Boris Yeltsin first sent troops into Chechnya, his declared goal was to “restore constitutional order” and ensure “a normal, peaceful and calm life”. Moscow had done little when Chechnya declared independence in 1991: it was a mess, not a threat. But an unpopular Mr Yeltsin was persuaded by hawks in the Kremlin that a triumphant reconquest of the republic would boost his cause.

A 21-month bloodbath followed, ending in 1996 with ignominious Russian retreat and de facto Chechen independence. Even then, the damage could have been contained. Most Chechens wanted to keep close links with Russia, and their post-war president, Aslan Maskhadov, was once a Soviet army officer. But Chechnya needed help: financial, practical and moral. There was no work. Thousands of armed men bore the scars of war. The absence of a political settlement added to instability. But instead of working for one—perhaps extreme autonomy, if not independence—Moscow connived in the disintegration of Mr Maskhadov's authority.

Western governments decided that Chechnya did not justify offending the Kremlin. By 1998, the republic had fallen into a black hole. Kidnapping flourished; aid workers fled. Foreign Islamic fighters—hated by most Chechens, but appealing to extremists—began arriving. In 1999 Shamil

Basayev, a long-serving hardline Chechen commander, led his guerrilla fighters on a bloody foray into neighbouring Dagestan. Shortly afterwards, Russian troops rolled back into Chechnya.

Chechnya may have been out of control, but renewed war was not inevitable. Several events in the run-up to it remain murky, notably the tower-block bombings in Moscow and elsewhere in 1999, which were widely blamed on Chechens, but with suspicion falling also on Russian security services. Kremlin power-brokers wanted to push the newly appointed prime minister, an unknown ex-KGB officer named Vladimir Putin, into the presidency. The new war made Mr Putin. When he vowed to corner the bandits “in the shithouse” and wipe them out, he galvanised Russians who were depressed by the late Yeltsin years.

Moreover, many Chechens fed up with the independence experiment were ready to welcome Russian troops. But despite promises of “surgical strikes” and “special operations”, the 1999-2000 offensive proved totally indiscriminate. Valentina, a Russian pensioner in Grozny, says she looked forward to being liberated. But the first soldiers she met called her a “bandit, prostitute and bitch” for living among Chechens. One fired his Kalashnikov around her feet. Others shot and burned out her neighbours. “That was Russia,” she says.

Some 10,000 Russian soldiers, by official figures (or 20,000, by conservative unofficial estimates), have died in the two wars. Chechen losses have been far worse: 50,000-200,000, out of a population of 1m. The war is now an underground struggle, in which rebels and security forces infiltrate each other, informers are rife and the gun rules. A compensation scheme for destroyed homes has brought new corruption. To receive the top payout of $13,000 can take a bribe of half that amount. Millions of dollars in reconstruction funds have vanished. Indeed, money prolongs the war: rumours abound of arms sales by Russians, not least to rebels, and both sides profit from smuggling and kidnapping.

Although the obliterated centre of Grozny bustles with traders in daylight, it is deserted at night. This is when snatch squads raid houses for those they suspect of helping the rebels. Masked soldiers never show their identity. Many prisoners vanish, or are found dead. Numbers have fallen from the peak in 2000, but last year at least 386 people were abducted, usually by security forces, according to Memorial, Russia's top human-rights group.

Comparisons are often made with the Stalinist 1930s. “One day you say something wrong, the next you disappear,” says a woman named Leila, as she collects water from a rusty street pipe. Even Chechens enlisted with Russian forces are fearful. “These type of people have the instinct of occupiers: that everything is allowed and no one will punish them,” one officer says. “People are sick of it. They were hoping for order. But whom can they turn to?”

Russian courts seldom hear Chechen allegations of murder or torture, and going to the European

Court of Human Rights in Strasbourg is tortuous. No wonder so many flock to the armed resistance. For all the talk of al-Qaeda in Chechnya, it is the cycle of impunity, brutality and poverty, not Islamist ideology, that fills rebel ranks. “If they keep up these methods of so-called ‘anti-terrorism’, I think the problem will spread right through the region,” says Timur Akiev, at Memorial. “The Russians are creating terrorists.” Ah well, at least there's that emergency helpline.

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Charlemagne

The reds in the West

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The European Union's courtship of China—and its implications for America

WHEN Hu Jintao, China's president, visited Paris a year ago, the French government celebrated by bathing the Eiffel Tower in red light and staging a dragon parade along the Champs-Elysées. Strangely, no such celebrations featured when George Bush visited Paris a few months later. France is not the only European country bending over backwards to please the Chinese. Last month Gerhard Schröder, the German chancellor, visited Beijing with 43 German businessmen. It was further confirmation that the European Union is hell-bent on wooing China, for a mixture of strategic and economic reasons.

The courtship is paying dividends. This week it emerged that the EU is now China's biggest trading partner: in 2004, trade between the two amounted to almost €160 billion ($210 billion), an increase of 35% over 2003. And within a few months the Europeans have made clear that they will take a step that will delight the Chinese and enrage the Americans, by lifting the arms embargo that has been in place ever since the Tiananmen Square massacre of 1989.

The looming transatlantic row over China is the more striking because in other respects European-American relations are improving. Mr Bush is due in Europe next month, on a trip explicitly intended to mend fences. Javier Solana, the EU's ebullient foreign-policy chief, visited Washington, DC, recently, and got on famously with all and sundry. Mr Solana says that he concluded that the Americans could “live with” the lifting of Europe's arms embargo on China.

The Americans retort that, if Mr Solana got that impression, he was simply not listening hard enough. On the contrary, at every stop of Mr Solana's extended traipse around Washington, from the Pentagon to Congress to the White House, his interlocutors stressed that any decision to lift the EU's arms embargo would go down very badly. Richard Lugar and Joe Biden, two senior senators who are in general well-disposed towards Europe, were particularly fierce.

American concerns are easy to understand. A few years ago, when Chinese threats to invade Taiwan became particularly vocal, the Americans sent an aircraft-carrier through the Taiwan Strait. Since then, China's arms build-up has only accelerated. The People's Republic now has hundreds of ballistic missiles pointing at Taiwan, to deter “splittist” tendencies. The possibility that American and Chinese forces might one day clash over Taiwan cannot be discounted. So the idea that America's NATO allies in Europe might actually aid the Chinese arms build-up seems abhorrent to Washington.

The European response to this is soothing. The lifting of the arms embargo, they insist, would be “symbolic” in nature. The only other countries on which the EU imposes an arms embargo are such pariah states as Myanmar and Zimbabwe. Putting such an important place as China in the same camp is insulting. The decision to get rid of this slur would not be motivated by any unseemly desire actually to sell the Chinese any weapons—of course not. To prove this, the EU will

put in place a toughened “code of conduct”, which would stop any EU country from selling weapons that might upset the regional balance of power or threaten the interests of an ally.

The Americans are not convinced. What, they ask, will happen if the Europeans have a particularly lucrative contract dangled in front of them? Will it not be tempting to read the rules in the laxest way possible? Such concerns are particularly pointed since it will be left to individual EU countries to interpret the code of conduct. France, which is the country pushing hardest for the lifting of the embargo, is also one of the world's largest arms exporters. (Ironically, one of the liveliest recent corruption scandals in France concerns the sale of frigates to Taiwan in the 1990s, but then business is business.)

The Americans are especially concerned about technology exports to China. The Chinese can make their own guns and tanks, or import them from Russia. But they would love to get more high-technology and communications equipment that could improve battlefield management. America was able to stop Israel from selling China its sophisticated Phalcon air reconnaissance system. But Europe is an obvious place to shop. The EU is already the largest exporter of high technology to China, and China is investing €200m in the EU's Galileo project, a supposedly commercial satellite system meant to free Europe from its dependence on America's rival GPS system.

The China syndrome

Is it possible that more American pressure may dissuade the Europeans from lifting their embargo? Probably not. “That train”, says one senior EU official, “left the station and has been gathering steam for some time.” Even Britain and the Netherlands, which often share American concerns, are unlikely to block the decision; this week Jack Straw, the British foreign secretary, said the embargo would go in the next six months. Britain too has an arms industry and commercial interests in China.

For the French, wider ideological issues come into play. Mr Chirac is the strongest proponent of replacing American hegemony with a “multipolar world”. On a visit to Beijing last October he declared that France and China shared “a common vision of the world—a multipolar world.” David Shambaugh, a Sinologist at the Brookings Institution in Washington, argues that China and the EU represent “an emerging axis”, based on the fact that “China and Europe share a convergence of views about the United States, its foreign policy and its global behaviour.”

That exaggerates the unanimity of opinion within Europe. But the EU is still poised to take a unanimous decision to lift its arms embargo. That would mark a significant milestone: a moment when Europe had to make a choice between the strategic interests of America and China—and chose China.

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Universities

Can foreigners prop them up?

Jan 13th 2005
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British universities rely increasingly on foreigners to supplement government-capped fees. Not for long, they can't

Get article background

FOREIGN students keep British universities from crumbling. Some 9% of students come from outside the European Union (EU). Their numbers rose by a quarter last year.

There are good academic reasons for wanting foreign students, but the main motivation is mercenary. Foreign students subsidise the loss-making teaching of home students (and of the EU ones, who pay domestic rates). They pay £8,000 ($15,000) a year, compared with the £5,000-odd in fees and subsidies that universities get for an average home student. Ivor Crewe of Universities UK, a lobby group, calls them “essential”. The state-funded culture-promoters at the British Council say they are “crucial”. Sir Howard Davies, director of the London School of Economics (LSE), terms them “integral”.

The LSE balances the books on undergraduate teaching by having one foreigner for every home student. At the mid-ranking Middlesex University, foreigners' fees are up 16% this year; they already make up a fifth of the budget and will soon, says the vice-chancellor, Michael Driscoll, overtake the subsidy for home students.

Things are looking rosier still now that Britain's biggest competitor in higher education, America, has driven away tens of thousands of potential students by tougher visa rules. Demand from China is huge (it has been rising by more than 50% a year) and the British brand is strong. For university administrators who face low budgets and political interference at home, the export market looks good.

Some British universities are indeed nicely placed. They may include the best ones—such as the LSE—and those such as Middlesex which have devoted time and effort to making foreign students feel happy. But others may find that their newfound fortunes evaporate as quickly as they came. Roger King, a former vice-chancellor who is now a consultant in the international education business, says some are “more complacent than they ought to be—you've got the makings of blood on the carpet in four to five years' time”. Bahram Bekhradnia, of the Higher Education Policy Institute, a think-tank, says growth could prove “volatile”. Early data suggests it has slackened this year.

There are three main reasons to worry. One is growing competition, including from continental European universities which are now aggressively marketing post-graduate courses for overseas students, and from American universities which want to grow abroad. Foreigners are becoming more demanding. “The idea of simply hoovering up students from China and India and churning them out may not be sustainable,” says Sir Howard. China's long-term ambition, he notes, is to

develop its own universities—and not only for its own students: an increasing number of people from other Asian countries are choosing to study there too. China is encouraging foreign universities to open campuses there—much more demanding than cramming existing lecture theatres.

Second, what Britain is offering is not as good as it could be. For a start, most universities have concentrated more on winning customers than on pleasing them. Yvonne Turner of Newcastle University, who researches foreign students' problems, says that many find British student life off-putting. Traditional universities often regard foreigners as a necessary nuisance. “For some academics, work with lots of diverse students is a hassle,” she says.

Universities are beginning to think about this. Last year there were at least a dozen conferences on how to handle foreign students; three years ago Ms Turner remembers only a couple. But looking after outsiders properly is expensive, and universities often plead poverty. That's odd, given what the foreigners pay.

Foreign students also find it hard to open bank accounts, to get jobs, and to gain and renew visas. That drives some students elsewhere: visa hassles cost Middlesex £1m last year, says Mr Driscoll.

The third worry is that many British courses, particularly undergraduate ones, are stiffly priced for what they offer. Foreigners may be prepared to pay a bit extra to study alongside British students, but if a big slice of what they are paying is creamed off, they may look elsewhere. “There is a degree of hard-to-defend cross-subsidy,” admits Sir Howard.

Like customers everywhere, foreign students will look for value for money. British universities can offer that—but only if the government lets them set higher prices at home.

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Guantánamo detainees

Home soon

Jan 13th 2005
From The Economist print edition

Dodgy claims surround the release of the last British Guantánamo detainees

AFTER nearly two years of what Jack Straw, the foreign secretary, described as “intensive and complex discussions” between Britain and America, the remaining four Britons in Guantánamo Bay are to be released. They are due to return to Britain within the next few weeks after being held without charge for nearly three years.

The Pentagon said the deal was clinched after Britain had “made a number of security assurances” including agreeing to “work to prevent [the men] from engaging in or otherwise supporting terrorist activities in the future”. But, announcing the imminent release on January 11th, Mr Straw told the House of Commons that “no side undertakings” had been given.

When the first five British Guantánamo detainees came home last March, they were promptly arrested under the Terrorism Act 2000, but were released without charge after just a few hours questioning. This time, it could be different. The fact that the four remaining Britons were not released at the same time as the others suggests that the suspicions against them were more serious. Two had been designated for trial before special military commissions. But getting enough evidence for a prosecution before English courts may prove very difficult, if not impossible.

Prosecuting terrorist suspects is never easy. Of the 664 people arrested in Britain under the Terrorism Act since September 11th 2001, less than a fifth have been charged with terrorist offences, and only 17 have been convicted. Nearly half have been released without charge.

The Cuban base has been a running sore in America's relations with its closest ally in George Bush's “war on terror”. “We regard the circumstances and conditions of all detainees [in the camp] as unacceptable,” Mr Straw recently declared. In private, the language has been a lot stronger, particularly since the revelations of prisoner abuse at Abu Ghraib in Iraq has lent credence to allegations of similar abuse at Guantánamo. Four former British detainees who claim they were tortured are suing Donald Rumsfeld, America's defence secretary, for £6m ($11m).

“Had it not been for the nature of our alliance...we would not have got back those nine detainees,” Mr Straw said this week. But around 200 other Guantánamo detainees, many from countries with no special relationship with the United States, have already been released. Some 550 remain. Most are no longer of any intelligence value, American officials admit. Indeed, they have become an embarrassment, and an expensive one at that. Expect more releases.

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Religion and politics

Oh come all ye faithful

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How complaining brings surprising groups together

THE BBC's broadcast last week of “Jerry Springer—The Opera” earned the dubious honour of being the most complained-about event in British broadcasting history. Almost 50,000 protests poured in, 30 times the previous record. Most were from Christians upset by the show's depiction of Jesus, Mary and other religious figures. In the end, of course, the bad publicity was good for business—1.8m people watched, almost double what an opera usually attracts.

Controversy over entertainment that offends the faithful is hotting up. Last autumn, the BBC cancelled an adult-oriented cartoon series called Popetown—featuring an infantile pontiff on a pogo stick—because of Catholic anger. The internet may be one reason why broadcasters are feeling the pressure—the more wired the nation becomes, the easier it is to start a campaign—but e-mail is not the only way in which objections manifest themselves. In December, a group of Sikh protesters trashed a theatre in Birmingham that was hosting a play they found offensive.

Protests over “blasphemy” in the arts are not new. Mediawatch, a Christian outfit that campaigns against indecency in broadcasting, has been operating since 1964. But because of the long, slow decline of British Christianity, and the religious vitality of Britain's newer citizens, the British religious lobby today is strikingly multicultural.

For example, the Sikh group complaining about the play in Birmingham was encouraged by supportive noises from the town's Catholic and Anglican bishops. Then, as the controversy over Jerry Springer began, the Sikhs returned the favour, backing Christians in their efforts to prevent the broadcast going ahead. “We feel nobody has the right to make a mockery of any religion,” Gurdial Singh Atwal, the group's leader, told a BBC radio interviewer.

Such ad-hoc alliances are increasingly common. A question on religious faith was included in the 2001 census with the support of Hindus, Muslims and Sikhs. Muslim leaders contacted evangelical Christians last year for advice on how to oppose the Gender Recognition Bill, which gives equal rights to transsexuals. And when the government's advisers recommended banning traditional Jewish and Muslim methods of slaughtering animals, both lots lobbied against the measure. The Muslim Council of Britain, one of the organisations involved, seems confident that the government will back down.

Of course, such alliances can go only so far. Jews and Muslims may agree that they should be able to butcher animals in the traditional way, but they rarely see eye-to-eye on matters that involve their co-religionists killing each other, like events in the Middle East. Tension has flared over the visits to Britain of Yusuf al-Qaradawi, an Islamic scholar with a big international following. Jews want him kept out of the country because he condones suicide bombings. But such a bar would enrage British Muslims.

Yet unity does not necessarily lead straight to power. Don Horrocks, of the Evangelical Alliance, a Christian body, recalls attending a government-sponsored event last year to discuss policy with ministers, along with representatives from other faiths. “What was fascinating was that we all said the same thing about the same issues, like family values in society,” he says. “But the ministers didn't want to hear it.”

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Mobile phones and risk

I'm on the train, frying my brain

Jan 13th 2005
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Mobile phones still seem to be safe, but nobody wants to hear that

"THERE is as yet no hard evidence of adverse health effects on the general public," Sir William Stewart, chairman of the National Radiological Protection Board, an organisation that sounds as though it belongs in a 1960s B-movie. "But because of the current uncertainties we recommend a continued precautionary approach to the use of mobile-phone technologies." To a Popper-reading scientist, that's a little like saying: although there's no evidence that the sky is going to fall in, you should hide under your desk anyway.

Since ministers flatly denied there was any danger to people from mad-cow disease, Britain's government and press have been jumpy about public health. That helps explain Sir William's attitude, the scary headlines it generated and a decision by Communic8, a handset-maker, to withdraw a phone aimed at children.

One possible danger identified by the report concerns mobiles with a high specific energy absorption rate (SAR), a measure of the energy the head absorbs while the user is talking. Different phones have different SAR values, and the report recommends choosing a phone with a low one. But the SAR also depends on things like how close a user is to a mobile phone mast (the further the mast is, the more your brain gets cooked) and how garrulous the user is (people who listen rather than talk will have cooler skulls). One way to reduce the SAR is to have lots of masts. But people tend to think they are dangerous too, so that would be unpopular.

Even when a phone does heat up its user's head, it is not clear what is particularly bad about that. Adam Burgess, a sociologist at Kent University who has written about mobile phones and public fears, has pointed out that humans survive warm baths. A Swedish study has shown an increase in acoustic neuromas (a non-malignant tumour of the nerve that supplies the ear) in people who have used mobiles for ten years. But critics point out that the study has not been replicated, and that old mobiles might have had different effects from current ones. Even so, the nervous will be relieved to know that a hands-free kit reduces the SAR by about half.

Anyone who wants a definitive answer will probably have to wait a long time. Concerns about the public-health effects of overhead power lines were first outlined in a paper in 1979. Some people are still not satisfied that they are safe.

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Ramsgate's renaissance

We will fight them on the beaches

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How the broken system for funding councils creates suspicion

QUEEN VICTORIA liked to ride her donkey along the sand at Ramsgate, which was then a fashionable resort among bourgeois Londoners. They came by train or paddle steamer, bathed in the sea, or in one of the 20-odd types of bath in the Granville Hotel, and strolled around the town's Georgian and Regency terraces and squares. Samuel Taylor Coleridge scribbled away in a house on the clifftop, as did Wilkie Collins. J.M.W. Turner painted the view. Now, according to the locals, that bit of town will be wrecked by a beachfront development, incorporating over 100 flats and a hotel. The culprits are economic growth and a hard-up council looking for ways around the dysfunctional system for raising cash.

Until recently, North Kent's coast specialised in glamorous decay, punctuated by brightly-coloured candy floss and smoke-filled amusement arcades. In the 1970s, tourists stopped coming, pensioners moved in and the guest-houses filled up with people on unemployment benefit. Even though the area is part of Britain's most prosperous region, it is still older and has more single-parent households per head than the England and Wales average, according to the 2001 census.

But things have started to change. There are new ways to get to Ramsgate: a new stretch of dual carriageway, a ferry to Belgium and a nearby airport with cheap flights. Unemployment has fallen from 14% ten years ago to under 5% now. House prices have risen. Five years ago, the apartment next door to Coleridge's would have cost around £60,000 ($97,000), according to an estate agent. Now it would fetch between £120,000 ($225,000) and £180,000.

Thanet council, though, is still relatively poor. According to Bob Bayford, the council's deputy leader, the area has a disproportionately high number of people who depend on the public services it provides. And filling gaps in the budget is difficult. Although councils account for around a quarter of total government spending, the only variable they control is the council tax, which makes up 25% of their revenues. So to increase their spending by 1%, councils must put up taxes by 4%.

One easier, and electorally safer, way to raise revenue is for the council to sell land in areas that are attractive to developers. Thanks to Ramsgate's increasing prosperity, these are now more plentiful. Thanet council has raised £3.6m by selling the beachfront site, and it says the money will be ploughed back into services. “We are in a situation where we have to encourage people to do things,” says Mr Bayford.

Local campaigners, though, suspect more sinister motives. A councillor was investigated by the police when money to preserve an antique rollercoaster went missing. Suspiciously, the developer that bought the site is based in the British Virgin Islands. Fake banknotes bearing the face of the head of the council's planning committee have been passed around. “It's all fundamentally a bit iffy,” says Michael Child, who runs a bookshop in between writing letters to the council.

The real reason for the sale—balancing the books—may be disappointingly mundane. But given that central government will not trust councils to set their own taxes and budgets, perhaps it is unsurprising that their residents often suspect the worst of them too.

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Labour's economic claims

Boasters

Jan 13th 2005
From The Economist print edition

The dubious self-congratulation on Labour's campaign posters

GORDON BROWN joined forces with Alan Milburn, Labour's campaign supremo, and John Prescott, the deputy prime minister to unveil on January 11th Labour's poster campaign for the general election expected in May. He was there not just because the government wanted to pretend, after a week of feuding, that everybody was friends: the purpose of the posters is to boast about how well the economy has been doing with him in charge.

There are four claims. All are striking—and, in varying degrees, dodgy.

• Britain has had the longest period of sustained economic growth for 200 years. Labour neglects to mention that this period started in 1992, when the Conservatives were in power. The claim relies on quarterly GDP estimates. Annual figures show unbroken growth between 1949 and 1973—much longer than the eight years this government has been in power.

• Unemployment is at its lowest for 29 years. That's true of the official unemployment figure, which stands at 4.7%. But it is a tiny part of the employment picture. The posters are silent about the economically inactive, who are not included in the labour force and therefore not counted as jobless. Since 1997, inactivity has stuck at just over a fifth of the working-age population.

• Inflation is lower than at any time since the 1960s. It is certainly true that RPI inflation fell to just 0.7% at the end of 2001, the lowest since early 1960, but it currently stands at 3.4%, the highest since mid-1998. Anyway, since inflation has subsided around the world, Labour should not get much of the credit.

• Mortgage rates are lower than they have been for 40 years. True, but low inflation, not Labour, is the reason. For most of Labour's time in office, real interest rates have been around the level they were when it came to power.

The economy has certainly been doing better in the past few years than it was doing earlier. But the turning point was not in 1997, when Labour took office, but in 1992, when the Conservatives adopted an inflation target.

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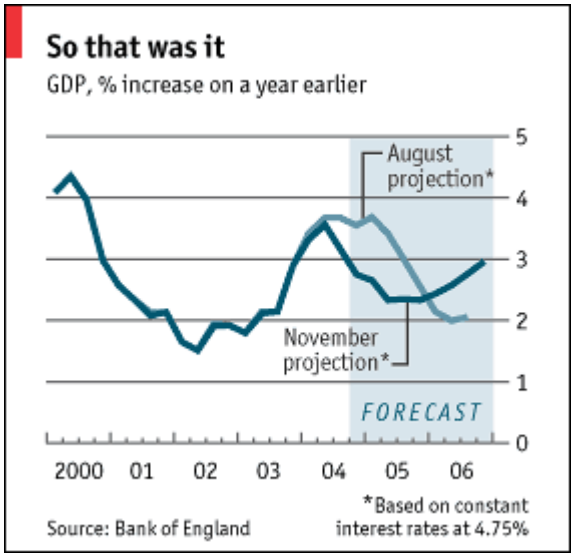
The economy

Year of living dangerously

Jan 13th 2005
From The Economist print edition

The economy is slowing more quickly than expected



Get article background

THE Bank of England kept its base rate on hold at 4.75% on January 13th. But the monetary-policy committee (MPC) will undoubtedly have discussed new signs of weakness that look to make 2005 a testing year for the economy.

In November, the Bank scaled back its forecast for growth in 2005 (see chart). Since then, it has become more worried about the slowdown in global growth. When it met in December, the MPC noted that world activity had been weaker than expected. It even discussed the possibility of reducing interest rates, although no member voted in favour of a cut.

Already, the economy has slowed down sharply after a vigorous recovery in the second half of 2003 and the first half of 2004. GDP grew in the third quarter by a below-trend rate of 0.5%. Economists at Goldman Sachs, an investment bank, expect a similar below-trend rate to be found for the last three months of 2004.

The slowdown has been concentrated in the industrial sector and reflects a disappointing trading performance, with imports growing more rapidly than exports. Trade figures for November released this week were better than expected. Exporters should also be helped in 2005 by last year's depreciation of the pound against the euro. However, the worry is that they will suffer from continuing sluggish growth in the euro area, which buys half of Britain's total exports.

This suggests that the economy will have to rely as usual on the strength of domestic demand. One source of growth will remain robust. Total government spending will increase by 4.6% in real terms, although this will be the last fling of Labour's big spree. The main question is what will happen to consumer spending, which accounts for two-thirds of the economy. Concern about the outlook for consumption will have been uppermost in the MPC's minds at the committee's first meeting of the year.

The British Retail Consortium reported this week that sales in December were the worst in the history of its series which goes back to 1993. This finding chimed with a string of disappointing trading figures from retailers over the Christmas period. The gloom may be overdone. The Financial Services Authority told companies that had traded poorly over Christmas to announce this promptly. Furthermore, consumers are increasingly bypassing retail stores and buying online.

Despite these provisos, the early evidence does suggest that consumers are pulling in their horns. In particular, retailers say that they are cutting back on the “big ticket” items, such as sofas, carpets and large electrical goods. This in turn suggests that consumer spending is already being affected by the downturn in the housing market. That downturn is continuing apace. The number of loans approved for house purchases dropped in November to 77,000, the lowest in nine years.

The big imponderable is how severely consumer spending will be affected by an ailing housing market. In the final years of the boom, the link between house prices and consumer spending weakened. But it could well reassert itself in a period of falling house prices. If that happens, Labour's relentless optimism will look silly.

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London's newspapers

Free for all

Jan 13th 2005
From The Economist print edition

The consequences of breaking a newspaper monopoly in London

ONLY Cadbury's chocolate is available in the slot machines on the London Underground, and only one sort of free newspaper is distributed at stations: *Metro*, owned by Daily Mail and General Trust (DMGT). But commuters will soon have a wider choice of rag. This week Ken Livingstone, the capital's mayor, said that he will tear up DMGT's exclusive deal with London Underground in order to allow a free paper in stations in the afternoon as well as *Metro* in the morning.

DMGT has many enemies. The government fears and loathes the *Daily Mail*, its principal title, like no other paper. In 2002 Mr Livingstone attacked the *Evening Standard*, its London evening paper, for its coverage of an incident in which he was described as being drunk and violent. Richard Desmond, owner of Express Newspapers, wants to set up a free London afternoon paper. He will be particularly delighted if the DMGT's monopoly ends, and not just for business reasons: the *Daily Mail* calls him a pornographer—with some justice, since he owns The Fantasy Channel, which screens adult programmes.

Most paid-for papers are doing badly, in both circulation and profitability, while free papers are doing rather well. That's why rival newspaper bosses have been complaining about DMGT's monopoly on tube and railway stations. They are the best places to distribute free papers, which can be left for commuters to pick up from bins: Britons tend to be wary of accepting hand-outs from people in the street.

Since 2003 the Office of Fair Trading has been investigating DMGT's contract with London Underground, Network Rail and other train operators, and a decision was expected shortly. But it looks as though Mr Livingstone may pre-empt it.

Mr Desmond is poised to introduce a free evening paper within eight to ten weeks of DMGT's monopoly ending. His quarry is not so much the *Metro* as the *Evening Standard,* which costs 40p. Mr Desmond's paper is likely to be even lower-brow than the *Standard*, as well as free. Mark Braley, publishing analyst at Deutsche Bank in London, expects the *Standard*'s sales to drop rapidly. It is likely to have to go free too. Already, last December, DMGT started handing out a free, short, mid-day version of the *Evening Standard* called *Standard Lite* in an attempt to head off Mr Desmond.

London Underground should do well if it allows more newspapers into stations. DMGT pays only £1m a year for its monopoly. If there were two proprietors paying, reckons a rival newspaper executive, London Underground should be able to extract as much as £6m.

DMGT won't suffer much. London papers make up less than a tenth of its revenues, and its shares fell by only 2% on the news. But that won't stop its many enemies celebrating.

Religious schools

God knows

Jan 13th 2005
From The Economist print edition

The slippery slope to selection

Get article background

TO ANYONE unfamiliar with the quirky rules and passionate wrangles of English state education, it sounds trivial. But it promises a revolution. A judge has said that the Oratory, London's best-known Roman Catholic secondary school, may still interview prospective pupils.

This matters because religious schools (run by churches, but mostly financed by taxpayers) are the best state schools in London. Tony Blair is a prominent parent. The government's plans for improving secondary education include more religious schools. But they are hugely oversubscribed. The children of those seen as not religious enough may be rejected and end up at schools where the results are bad and the behaviour worse; to avoid that, the middle classes will fork out thousands of pounds a year for private education. So the stakes are high.

The local authorities which oversee most London state schools dislike any form of selection in school admissions. They want to prevent popular schools from cherrypicking the best-behaved children, thus lowering the quality of other schools' intake. So religious schools' ability to choose their pupils has been whittled away. Last year the government issued guidelines stopping schools from interviewing pupils. The only remaining filter was paperwork—principally a reference from a priest.

But the Oratory, run by a formidably independent-minded head, John McIntosh, decided to ignore this. The school went to court, and last month a judge ruled that the guidelines were only advisory and that interviews could continue.

Now other religious schools want the same. Joan Olivier, head of Lady Margaret, a highly-regarded Anglican girls' school in south-west London, says she will raise it with her governors next month. Our Lady of Victories, a popular primary school, plans to reinstitute interviews for its 2006 intake. Dozens of others may follow.

Supporters of religious schools argue that interviews are fairer. Priests' references are notoriously unreliable. They also favour the middle classes, who are good at filling in forms and sweet-talking priests. Interviews may indeed help the devout but disorganised poor. But they make admission harder for the unchurched middle classes, who find it deeply unfair that their secular principles stand between their child and a good education.

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Bagehot

Why Gordon needs a holiday

Jan 13th 2005
From The Economist print edition

A sensible way of ending the Blair-Brown feud

WHEN Douglas Jay, a trade minister in the 1960s, went to “the Continent” he always took sandwiches with him; and although nobody suspects Gordon Brown of quite such a level of hostility to foreign parts, the chancellor's reluctance to leave home (except for America, which he likes) has fostered the belief that he shares the traditional Labour distaste for Abroad. His current trip to Africa has therefore aroused more interest than the average ministerial junket.

It is not entirely clear whether Mr Brown's travels are motivated purely by concern for the poor, or are tinged by competition between himself and Tony Blair for global brownie points. What is certain is that his new-found wanderlust delights many. No doubt the citizens of South Africa, Mozambique, Tanzania and Kenya top the list; but it seems likely that Mr Blair is also pleased by the broadening of his colleague's horizons, and is hoping that the trip serves to quicken Mr Brown's enthusiasm for distant places.

Both men probably feel that they could do with putting a little distance between them right now. The past week's newspapers have been dominated by one of those spats, played out in the press, which erupt with increasing frequency. This one was made evident by some competitive scheduling—the prime minister called a press conference which coincided with a long-arranged speech by the chancellor—and fuelled by a book. “Brown's Britain”, by Robert Peston, claims that Mr Blair repeatedly promised Mr Brown that he would step down as leader before the next election, which is expected in May.

Political journalists, of course, are delighted to have a story that has pushed the tsunami victims off the front pages. The Tories are thrilled, because the book has provided them with a quotation, supposedly from Mr Brown to Mr Blair—“there is nothing that you could say to me now that I could ever believe”—which they think chimes perfectly with the electorate's post-Iraq mistrust of the prime minister. They plan to plaster it all over their election campaign. Labour MPs are consequently furious, and gave both men—particularly Mr Brown—a bad time at a party meeting this week.

But the electorate seems to be taking the excitement in its stride. A poll in the *Times* on January 10th showed Labour at 38%—its highest for a year—and the Tories at 33%. Voters may be failing to punish Labour for its discord because they read exactly the same story late last summer, when Mr Brown's people first leaked the tale of the broken promise, or because they don't believe that any substantial issue divides the prime minister and the chancellor. Some voters, after all, remember when the party was in uproar over unilateral nuclear disarmament. It's harder to get stirred up by a dispute over whether or not foundation hospitals' borrowing limits should be subject to Treasury control.

But this squabble matters more than the polls suggest. In any organisation, when the top two

people fight, everybody stops work to chat about it around the water-cooler and important decisions get distorted by the conflict. So, for instance, when Mr Blair worked out last year that the university system would go under unless students paid more for their degrees, Mr Brown had no particular opinion on the issue; but he let it be thought that he supported a tax-based scheme. By thus helping to foment a rebellion against Mr Blair's plan, he ensured that fees were set at a lower level than Mr Blair had intended; and thus the feud has made for a bleaker future for Britain's universities.

That's why, boredom aside, everybody should want this to stop. One solution Mr Blair is said to be considering is to move Mr Brown to the Foreign Office after the next election. Unsurprisingly, Mr Brown is said to regard this less as solution than execution: if that happened, it is said, he would retire to the back benches and smoulder, with possibly incendiary consequences for the prime minister.

That is very likely what Mr Brown, one of Westminster's great sulkers, would do. But if he had more sense than vanity he would think about the offer.

Things can only get worse

Mr Brown has had an exceedingly good run as chancellor, but that may be over. Growth is slowing, public spending continuing to rise and taxes are bound to have to go up after the next election; the only question is by how much. Business, meanwhile, is getting increasingly grumpy about the chancellor's enthusiasm for loading it with new obligations.

What's more, Mr Blair realised some time ago that he made a mistake in devolving so much power over domestic policy to Mr Brown. He has already taken some away, by bringing back Alan Milburn, a former health minister, to produce what Downing Street promises will be an “unremittingly New Labour” manifesto; and he seems certain to grab more after the election.

The risk for Mr Brown, of course, is that one of his putative rivals might get the Treasury and supersede him as the prime minister's natural successor. But that danger could be avoided. Mr Brown and Mr Blair could agree on somebody too dull for the chancellor, even at his most paranoid, to regard as a rival for the leadership. Jack Straw or Alistair Darling, both of whom are close to Mr Brown, should do nicely.

Mr Brown needs an orderly succession as much as Mr Blair does. If the transition is messy, he might either lose the job altogether—as Michael Heseltine did when he stood against Margaret Thatcher—or take over a divided party—as John Major did. By moving to the Foreign Office he would avoid losing the credit he has gained for the economy's performance and he would help restore order in the party. He might even learn some skills he would find useful as prime minister, such as getting on with people outside his immediate circle.

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Dancing with the enemy

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AP

For all the hostility between Taiwan and mainland China, their respective economies are now deeply interdependent, says James Miles (interviewed here). That should help to keep the peace

“GIVE back our rivers and mountains,” says a slogan inside a military base on the tip of Kinmen (also known as Quemoy), a tiny island controlled by Taiwan but shrouded by the same polluted haze that envelops Xiamen, a port city on the communist-controlled Chinese mainland. A soldier on guard says giant loudspeakers inside the base still broadcast music across the 2km (1.2 mile) stretch of water to Xiamen.

The easy-listening fare, selected by Taiwan's “political warfare” troops, is a curious cold-war legacy on this fortress of an island. Taiwan's defence ministry will not say what it is for. But the original purpose of these broadcasts, which began after the inconclusive end of China's civil war in 1949, was to undermine the mainland's faith in communism and help to restore Taiwan's government as that of the whole of China. China had loudspeakers too, but they fell silent in 1991. It is decades since the two sides lobbed artillery shells at each other's broadcasting facilities.

Oddly, China would love it if Taiwan really wanted to regain control of the mainland. But the broadcasting station and the slogans are merely anachronisms. Taiwan's armed forces, led by officers who were either born on the mainland or had fathers who were, have found it hard to keep step with the rapid changes on the island. These days the goal of Taiwan's government is to assert the island's independence from China, ideally—though it dare not say so—a permanent one. But the barrack routine of shouting slogans calling for the reunification of Taiwan with the mainland was abolished only last September.

China knows that Taiwan is slipping ever further away. Since 2000, the island has been led by Chen Shui-bian, its first president from outside the Nationalist Party or Kuomintang (KMT) since the civil war. The main aim of his Democratic Progressive Party (DPP) is to bring about the island's

formal independence from China. Its charter calls for a Republic of Taiwan, not a Republic of China, as the island now confusingly calls itself. Mr Chen himself has vowed not to go this far, but China's leaders do not trust him. They have given warning that a declaration of de jure independence (such as by a change of name) would mean war.

Pessimists—and there are plenty of them in both Beijing and Washington—argue that in the remaining years of Mr Chen's presidency, which runs to 2008, tension between China and Taiwan could escalate, even to the point of armed conflict. Such a war could drag in the United States, Taiwan's main provider of moral and military support. If America decided to intervene, two nuclear powers would be pitted against each other. Japan, from where America would probably launch any bid to defend Taiwan, could find itself sucked in. The whole region could be plunged into turmoil.

Both China (economically) and Taiwan (politically) are evolving so rapidly that talk of preserving the status quo between them is no longer meaningful. Taiwan's smooth and rapid democratisation has allowed its people to redefine their identity. Increasingly, they no longer think of themselves as Chinese. They are Taiwanese, and mainlanders are foreigners. In China, too, nationalist sentiments are surging as the nation becomes more prosperous and the armed forces far more powerful.

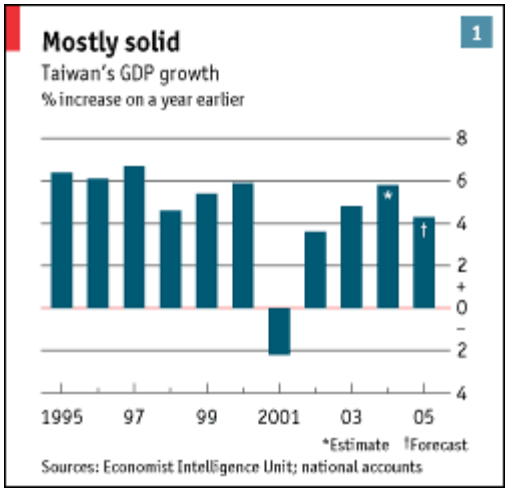
Fear of China helps to keep Taiwan's nationalism in check. In parliamentary elections in December, the KMT and its allies caused a surprise by maintaining their slim majority in the legislature. These parties won support for their less confrontational stance towards China, despite their lack of appeal to many native Taiwanese. But around the region and in America, there are worries that Mr Chen will continue to rile the Chinese, who might one day lose patience and respond with force.

This survey will argue that the chances of conflict are slim. For all the nationalistic exuberance of China, there is no sign of a shift away from the fundamentally pragmatic external policy of the last quarter-century. And Taiwan's leaders, for all their *braggadocio*, are pragmatists too. Not just China, but America, Japan and other big powers are urging them not to go too far. A renamed or redefined republic recognised by the same handful of insignificant states that now recognise Taiwan would gain nothing and probably lose a lot. President Chen may resent America's restraining hand, but he cannot do without it.

There is another remarkable transformation under way that will put just as powerful a brake on any slide towards war: the rapidly growing economic integration and interdependence of Taiwan (the world's 20th biggest economy), China (number seven) and America (number one). Doomsayers in Taiwan, who a few years ago gave warning of a rapid “hollowing out” of their country's economy as manufacturing migrated to China, have been proved manifestly wrong. China, with Taiwan's abundant help but not to the island's detriment, has become the pre-eminent manufacturing base for many of the world's information-technology (IT) products. Even the initially sceptical Mr Chen is beginning to realise that Taiwan can

only gain by working with China to remove the remaining barriers to cross-strait flows of people, goods and capital.

In the next few years there will be plenty of pro-independence rhetoric as the debate gets under way on Taiwan's proposed constitutional revisions that Mr Chen has said will be endorsed in 2006 and enacted two years later. But if he is sensible, the main achievement of his eight years in office will be not that he made Taiwan truly independent (which, in almost every respect, it has been for 55 years), but that he helped his country to gain unprecedented prosperity, shoulder to shoulder with China. To get there, he will need to ride the tide of Taiwanese identity with skill—and some caution.



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Turning Taiwanese

Jan 13th 2005
From The Economist print edition

The islanders are developing a distinct identity

Reuters

Chen says it with budaixi

TAIWAN'S deep fascination with a televised form of puppet theatre illustrates the complexity of what it means to be Taiwanese. *Budaixi*, as the art form is known, is an omnipresent feature of Taiwan's cultural and political life. The island's biggest *budaixi* production company, PiLi International Multimedia, says it has an annual turnover of $35m. A million people a week rent the latest PiLi shows on DVD. *Budaixi* puppets feature the wooden expressions and jerky movements of early TV animations, but the characters, costumes and plots draw on ancient Chinese sources, with a heavy dose of martial arts and special effects. The target audience is grown-ups as well as children. Politicians like to portray themselves as *budaixi* heroes.

Taiwan's 23m residents regard *budaixi* as Taiwanese, yet the genre has its roots on the Chinese mainland. The hand-held puppets were imported more than 200 years ago from Fujian province on the mainland coast facing Taiwan. *Budaixi* is the name for it in standard spoken Chinese, which the KMT forced the Taiwanese to use, but the natives still mostly speak a Fujian dialect. They are the descendants of Fujianese who fled to the island to escape upheavals on the mainland. Some trace their ancestry to the island's original inhabitants, Malayo-Polynesian-speaking peoples akin to those of Indonesia and the Philippines. China incorporated the island into its empire after putting down an insurrection there in the late 17th century.

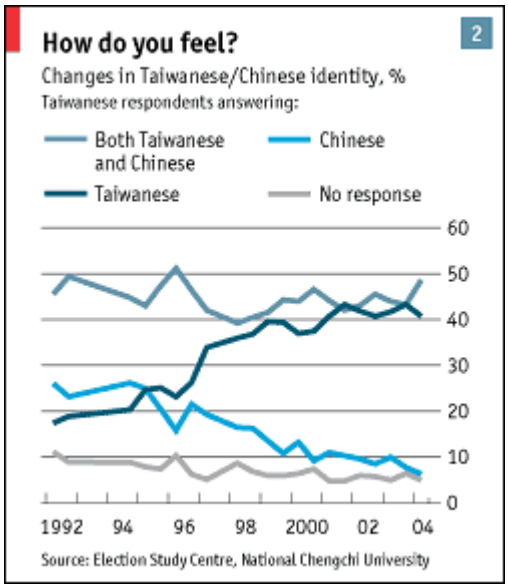
In 1895, China ceded Taiwan to Japan after being defeated in a war over control of the Korean peninsula. Taiwan still has strong cultural ties with Japan, and many Taiwanese take a fairly positive view of the colonial era. But the Japanese discouraged Taiwaneseness. During the second world war, they forced *budaixi* troupes to perform in Japanese and adjust their plots to extol the Japanese martial spirit.

The end of Japanese rule in 1945 brought little relief to the puppeteers. *Budaixi* now had to be performed in standard Chinese. In the 1960s, televised *budaixi* was banned for allegedly distracting islanders from their work. By the time Taiwan began moving towards a multi-party democracy in the 1990s, *budaixi* was in danger of dying out, but it became “intertwined” with a movement to revive Taiwanese culture, wrote Wu Sue-mei, a scholar at Carnegie Mellon University.

For all its moorings in the culture of the mainland, Taiwan's version is now being touted as something very distinct. For President Chen and his generation, the struggle for democracy on the island and the struggle for a Taiwanese identity amounted to much the same thing. It pitted native Taiwanese against the “mainlanders”, the label attached to those who arrived with the KMT in

1949 (and their offspring). Mainlanders make up about 15% of the population and still provide much of the support for the KMT and its allied splinter parties. But there are not enough of them to return the KMT to power. Democracy is forcing it to turn Taiwanese too.

Surveys conducted by Taiwan's National Chengchi University show a remarkable shift in Taiwanese self-perception over the past 12 years. The number of those identifying themselves as Taiwanese has risen from 17% to 41%, whereas those who see themselves purely as Chinese have dropped from 26% to 6% (see chart 2). This alarms the government in Beijing, which not unreasonably suspects Taiwan's leaders of pursuing a deliberate policy to "de-sinify" the island.



Chinese? Us?

This view is shared by some opposition politicians in Taiwan, and it is true that President Chen is fostering Taiwaneseness, but he is doing it because it is popular. Admittedly the policy does not encourage support for reunification with China, but nor does it seem to detract from the public's strong support for the preservation of the current ambiguous relationship with China. Polls suggest that less than 10% of Taiwanese want independence "as soon as possible", a figure that has hardly changed in recent years. No doubt China's sabre-rattling plays its part in that.

Yet the new emphasis on Taiwanese identity is making it harder for the DPP to cloak its dealings with the mainland in ambiguity. In 1992, when Taiwan and China began discussions between nominally non-governmental bodies set up by both sides to disguise their official contacts, they agreed on the notion of "one China" but deliberately left open exactly what that meant. China broke off the talks in 1999 after Mr Chen's predecessor, Lee Teng-hui (of the KMT, but born in Taiwan and very pro-Japanese) proclaimed that Taiwan and China were separate states.

Now talk of "one China", with Taiwan as one of its components, has become dangerous for Taiwanese politicians. Ma Ying-jeou, the charismatic KMT mayor of Taipei, who is widely regarded as a potential future leader of his party, says that using the term would be political suicide in Taiwan. China, for its part, would clearly not be happy with Mr Ma's suggestion that Taiwan and China model their relations on that between the two Germanies before their unification. For China, the Taiwan problem is the result of an unfinished civil war. It would find simultaneous recognition of two separate Chinas almost as abhorrent as Taiwan renouncing Chineseness altogether.

Galling though it is for China, Mr Chen's emphasis on Taiwan's identity has helped win him votes. But he can go only so far. In the build-up to December's parliamentary elections, Mr Chen angered China's leaders with his calls for a new constitution for the island, to be approved by a referendum, and for provocative name changes for government offices and state-owned enterprises. Taiwan's nervous voters responded by denying the DPP and its allies the majority in parliament on which they had set their sights.

But China knows that threats of war do not reinforce Taiwan's identification with the mainland. Some officials in Beijing still hope that economic interaction with Taiwan will make people in the island feel more Chinese again, but many now have their doubts. "My Taiwanese friends ask me, what do we get out of reunifying with the mainland? It's a difficult question," concedes Wang Jisi of the Chinese Academy of Social Sciences. "I cannot think of many attractions."

Although China feels a little more relaxed after December's election results, it still fears that Mr Chen will now look for ways of backing down from his promise not to make any constitutional changes that would affect the island's official name or the definition of its sovereign territory. America is also worried. In December 2003, President Bush, with China's prime minister, Wen Jiabao, by his side, dressed down “the leader of Taiwan” for challenging the “status quo”. Mr Chen got the message and watered down provocative plans for a referendum on cross-strait issues.

China crowed. “America doesn't want to see Taiwan becoming independent, war breaking out across the strait and America being dragged into the water,” says Zhang Mingqing, a Chinese spokesman on Taiwan affairs. “America has the problem of fighting terrorism, the Iraq problem and the North Korean nuclear problem. It does not want a problem with Taiwan.”

Since his censure by Mr Bush, Mr Chen has tried to repair relations with America, sending drafts of important public documents on cross-strait issues to Washington in advance. Michael Kao, Taiwan's deputy foreign minister responsible for ties with America, says he has been explaining to the Americans that President Chen is “a pragmatic lawyer, not a political ideologue”. Mr Chen, he says, is trying very hard to “hold the line so that political movements in Taiwan would not push him to [declaration of] de jure Taiwan independence”.

But Bush administration officials are not entirely convinced. They held extensive discussions with their Taiwanese counterparts on a speech that Mr Chen was to deliver on the occasion of Taiwan's national day on October 10th. The speech was billed by Taiwan as an important overture to China. But to the Americans' surprise, it contained last-minute additions, not cleared in Washington, that challenged the decades-old principle of overlapping sovereignty between the Republic of China and the People's Republic of China. “The sovereignty of the Republic of China is vested with the 23m people of Taiwan. The Republic of China is Taiwan, and Taiwan is the Republic of China,” Mr Chen said. And just to make sure everybody got the point, he said that Taiwan was “a country of 36,000 square kilometres”, in other words, just the island and a few islets.

Radicals in Mr Chen's party and in its main ally, the Taiwan Solidarity Union, want Taiwan to revise its constitution to clarify its de jure independence, arguing that the island has only a narrow window of opportunity while China is preoccupied with its preparations for the 2008 Olympics. China, the theory goes, would avoid a war in order to ensure the success of the games, which it wants to mark the country's emergence as a great power.

Without a legislative majority or evidence of strong public support for a referendum, Mr Chen could not achieve this even if he wanted to. Personally he seems to prefer a gradualist approach, stopping short of the final, formal change. In his first term of office he enraged China by adding the word “Taiwan” to Republic of China passports. He has recently suggested a change of tactic in the island's dogged but futile attempt to join the United Nations: it is now asking for admittance as Taiwan, not the Republic of China. This has caused anxiety in Washington, where officials resent his goading of China and feel he does not understand the risks he is taking.

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The dragon next door

Jan 13th 2005
From The Economist print edition

War with China may not be likely, but if it happened it would be devastating

“AT THE beginning of this new century, nowhere is the danger for Americans as great as in the Taiwan Strait, where the potential for a war with China, a nuclear-armed great power, could erupt out of miscalculation, misunderstanding or accident.” So argues Nancy Bernkopf Tucker, an American scholar, in an edited volume, “Dangerous Strait”, due to be published shortly. Other threats may be more certain, such as conflict in the Middle East, terrorism or clashes with rogue or failed states, yet “none but a collision with China would be as massive and devastating,” Ms Tucker suggests.

Since 1995, China has been engaged in a rapid military build-up on the coast facing Taiwan, triggered by the then President Lee's visit to his alma mater, Cornell University. China was incensed by America's willingness to give a Taiwanese president a public platform on American soil. It saw the event as confirmation that Taiwan's democratisation was strengthening international support for Taiwan's separateness. Military pressure, it felt, was needed as a warning to Taiwan and the Americans about the dangers of going too far.

In 1995 and 1996 China staged large-scale military manoeuvres in the Taiwan Strait, including the firing of unarmed missiles close to Taiwan's two main ports. America responded with its biggest naval deployment in the region since the Vietnam war, sending two aircraft-carrier battle groups to the area. China has fired no more missiles since, but has positioned large numbers of truck-mounted short-range ballistic missiles (SRBMs) along the coast. It has also increased deployments of longer-range missiles that could target American bases in Japan or on the Pacific island of Guam, about 1,500 miles from Taiwan. And it is working to develop land-attack cruise missiles, which could be fired across the 160km (100 mile) strait and penetrate even the most sophisticated anti-missile defences that Taiwan is acquiring from America.

China has also been buying an array of Russian weaponry, from SU-27 and SU-30 fighter jets to quiet Kilo-class submarines and Sovremenny-class destroyers. These ships are equipped with Sunburn anti-ship missiles, the ones America's navy “fears most”, says Peter Brookes, a former senior defence official in the Bush administration. Russian-supplied anti-aircraft batteries on the coast can lock on to Taiwanese aircraft as soon as they take off from the island. The technical superiority of Taiwan's weaponry could well be overtaken by China's within a few years.

Kurt Campbell, the Pentagon's senior official responsible for the region at the time of the crisis in 1995-96, says the biggest cautionary tale was how difficult America found it to communicate with the Taiwanese and to understand their capabilities and intentions. This did not bode well should the two sides find themselves fighting together against China. So the Clinton administration decided to step up contacts with the Taiwanese armed forces, including mutual visits and training of Taiwanese officers.

In 2001, after George Bush became president, the Republican administration strengthened these ties. Mr Bush also offered to sell Taiwan a huge package of advanced weaponry and help it buy diesel submarines. As Michael Swaine, an American academic, notes in “Dangerous Strait”, reports

suggest that there are now more American military programmes in progress with Taiwan than with any other major American ally. And America has been adding to its submarines and bombers stationed on Guam.

But Taiwan itself is curiously ambivalent about China's growing military prowess. The purchase of new weapons from America has become bogged down in fierce political debate on the island, with many arguing that they are too expensive, will take too long to acquire and integrate into the Taiwanese military, or will simply fuel an arms race with the mainland. American requests that Taiwan do more to protect vital structures such as command-and-control centres and airfields have met similar foot-dragging. Taiwan's defence spending as a share of GDP has been declining for several years, to around 2.4% in 2003, below South Korea's (2.8%) and well below China's (see chart 3). In 2005 it is set to rise to 2.5%.

Look at it our way

The problem, according to James Mulvenon of the Centre for Intelligence Research and Analysis, an American consultancy, is that there is a “fundamental perceptual difference” between Taiwanese officials and American ones about the nature of the Chinese threat. The Americans brief their Taiwan counterparts on Chinese military capabilities, he says, but are “flummoxed” by their unwillingness to accept that “the threat is imminent”.

The Americans are also worried that these days the Taiwanese talk a lot more about acquiring offensive capabilities of their own. The prime minister, Yu Shyi-kun, last September famously threatened missile strikes against the mainland should China attack Taiwan. “If you hit us with 100 missiles, we'll fight you back with 50 missiles,” he said. “If you hit Taipei or Kaohsiung, we'll strike Shanghai.” To the many Taiwanese who balk at spending $18 billion on America's proposed arms package, offensive weapons seem a more cost-effective way of deterring an attack.

Taiwan has been working for several years to develop supersonic cruise missiles that could hit mainland targets. Since President Chen took office, it has installed less advanced subsonic anti-ship missiles on outlying islands that could also hit the mainland. These moves worry some in the Pentagon, who think that in the event of conflict a Taiwanese attack on the mainland could escalate out of control. Naturally, they also anger China.

There are concerns, too, that Taiwan might secretly acquire nuclear weapons. President Chen has ruled this out. But Taiwan has tried in the past to make such weapons behind America's back. As recently as the late 1980s, the Americans put a halt to a suspected nuclear-weapons programme in Taiwan. Some commentators there say it should be revived. China has said it might attack if Taiwan goes nuclear. “If I had to nominate an area that was ripe for a strategic surprise in the next three or four years, I would probably place China-Taiwan at the top of the list, above North Korea,” says Mr Campbell.

Policymakers in Washington are right to worry about the risks, but the chances are that Chinese leaders would think more than twice about mobilising their arsenal. Politically, any military action against Taiwan could well prove riskier for China than doing nothing. “The risk of failure weighs pretty heavily on a lot of the senior leadership [in China],” says a Pentagon official. A war that failed to achieve Taiwan's submission would be a powerful blow to the party's credibility. And it is hard to see how, even if China were to subdue Taiwan's armed forces, it could be confident of a

lasting political solution that would rule out any return to independence.

A war would come at a terrible economic price, not only for Taiwan but for China too. And one thing Chinese officials seem to agree on is that the party's grip on power depends on a vibrant economy.

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Onshoring

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Taiwan is shifting much of its manufacturing to the mainland

IN THE smoke-and-mirrors statistics for foreign investment in China, Hong Kong appears as the biggest investor, followed, oddly, by the Virgin Islands. Trailing in sixth place, behind Japan, South Korea and America, is Taiwan. But if investments were traced back to their true origins, Taiwan might well turn out to be the largest.

The capital flow from Taiwan to China is turning the mainland into a global leader in information-technology (IT) equipment, albeit one that still relies mainly on imports for the more advanced components. In 2002, China overtook Japan and Taiwan to become the world's second-largest IT hardware producer after America. The steep upward curve of China's IT exports is almost exactly matched by its imports of IT components from Taiwan. China is now the world's biggest IT hardware exporter to America. Yet more than 60% of these exports are made in China by Taiwanese companies.

China's latest list of its top 200 export companies is headed by subsidiaries of Taiwanese IT firms: Hon Hai Precision Industry (whose exports from China in 2003 were worth $6.4 billion), Quanta ($5.3 billion) and Asustek ($3.2 billion). Altogether Taiwan has 28 entries on the list, all of them high-tech companies. Far from being undermined by competition from China, Taiwanese IT businesses are benefiting from their production on the mainland, increasing their global market share across a broad range of products, says Nicholas Lardy of the Institute for International Economics in Washington.

Thanks to a huge trade surplus with mainland China, Taiwan has built up the world's third-biggest holding of foreign-currency reserves: a record $239 billion at end-November 2004. Taiwan is second only to Japan as a source of Chinese imports. And for Taiwan, China is the biggest export market. Taiwanese companies employ some 10m people on the mainland. For China, worried as it is about growing unemployment, this is an enormous contribution to stability. In just a few years, a strong economic symbiosis has developed across the Taiwan Strait.

Take the city of Dongguan in Guangdong province (which borders on Hong Kong). The municipality is a vast sprawl of factories, many of them Taiwanese, stretching mile after mile through what were tiny villages a few years ago. Dongguan is awash with Taiwanese money, much of which has been there for a decade or so. Dongguan was an obvious choice for the first wave of Taiwanese investors who flocked to the mainland after the Taiwan government began to ease investment restrictions in the early 1990s. It is close to Hong Kong, which together with nearby Macao offers the only direct flights from Chinese cities to Taiwan.

To start with, Dongguan was a magnet for low technology, labour-intensive industries. But since the late 1990s, Taiwanese investment in the mainland has moved rapidly up the technological ladder. Dongguan is still booming, but the investment hotspot has shifted north to the Yangzi River valley, particularly in the area around Shanghai, an area with good access to skilled workers and potentially better placed for China's domestic market. The town of Kunshan, an hour's drive from Shanghai, has become almost a replica of Taiwan's high-tech industrial zones. Some 300,000

Taiwanese businessmen and their dependants now live in the greater Shanghai area, causing property prices to soar.

Taiwan is rife with stories of kidnappings, robbings and murders of Taiwanese businessmen on the mainland. There is also speculation about how many really make money; Tsai Ing-wen, a former head of Taiwan's mainland-affairs office under President Chen, estimates that only half of them do. Even so, more than 70,000 Taiwanese firms have set up on the mainland, notwithstanding political tensions, Taiwan's restrictions on some investment and the absence of direct flights. “This is a time of global competition,” says Preston Chen, chairman of the Ho Tung Group, which has invested over $100m on the mainland. “If you don't go [to China], others will, and the first to suffer will be you.”

In Dongguan, some Taiwanese businessmen in low-value-added industries are getting restless as the stampede of Taiwanese capital shifts to the north. Some have begun to move elsewhere, including neighbouring Vietnam. “If you come back in ten years it's hard to say whether you'll find any Taiwanese business here,” says Juei Chen Wong, the boss of a Taiwanese electric-wire factory in Dongguan.

He is exaggerating: more likely, other Taiwanese businesses less dependent on cheap labour will move in. For labour-intensive manufacturers geared to the export market, China may be losing some of its shine. But the new wave of Taiwanese investment is looking for skilled labour, and is setting its sights not only on markets abroad but also on a fast-growing group of affluent consumers in China itself. This investment is helping to transform China's trade, now fuelled increasingly by higher-value-added production. In 2003, China exported some $130 billion-worth of electronic and IT products, up 41% on the previous year. Such products accounted for nearly one-third of total exports. Chinese officials say that output of IT products will triple by 2010.

To achieve this, China needs Taiwanese businesses, even if they support independence. In May 2004, the Communist Party's mouthpiece, the *People's Daily* newspaper, accused Hsu Wen-lung, the founder of Taiwan's Chi Mei Group, which has a large chemical plant on the mainland, of using his profits for pro-independence causes. But China has not taken any direct action against the company. “There are a very small number whom we do not welcome,” says Mr Zhang, the Chinese government spokesman. “But as long as they uphold the law, we let them invest. We have not said we will expel them.”

So near and yet so far

At government level, the two sides still bicker over what they call the “three direct links”: communication, trade and transportation, which have been disrupted since the end of the civil war. But barriers have been quietly dismantled. Mail is channelled through Hong Kong; direct telephone calls have been possible since the 1980s; cross-strait cargo shipping can be routed through a third area, but can go directly if not carrying local freight.

The absence of direct flights except to Hong Kong and Macao is the biggest nuisance, though it really is no more than that. If you set off an hour before dawn from downtown Taipei, you can reach most of the big cities on the mainland by the afternoon. But direct flights would certainly help. Getting to Shanghai currently takes six or seven hours. Flying direct would take 90 minutes.

The Taiwan government estimates that direct air and sea links would reduce shipping costs by 15-30%. Sea transport would be twice as quick, and air travellers would save $390m a year. But direct flights are fraught with symbolism, so both sides are determined to extract maximum political advantage from any move they make.

For Taiwan, direct flights are part of a bigger question: how much economic integration with the mainland it should allow. Should it stop trying to curb investment in certain technologies; open its doors wider to trade with the mainland; and allow mainlanders to work, invest and holiday in Taiwan? The economic arguments are compellingly in favour, particularly in information technology.

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Come and see my minefields

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A tourist attraction with a difference

Magnum Photos

Welcome to Kinmen

KINMEN, a small island nestled against the Chinese coast but belonging to Taiwan and occupied by 10,000 Taiwanese troops, badly wants visitors. Since the end of the civil war in 1949, its economy has depended on the military garrison. Islanders rushed to build hotels when Taiwan first allowed tourists (though not from China) to visit 12 years ago. But Taiwanese visitors are not much enamoured with an island ringed by minefields . The hotels are struggling and the property market has slumped.

In an effort to give its outlying islands a boost and show some goodwill to China, Taiwan in 2001 opened the “mini three links” between the islands and the mainland. It was not running much of a risk. Taiwan proper would remain aloof, and the Kinmen islanders would get some revenue. But things did not work out as planned. The visitors did arrive, because the new direct ferry service saved many Taiwanese businessmen hours of travelling time. But they hardly glanced at the little island as they shuttled to and fro.

Life on Kinmen has continued in its traditional sleepy way. The 60,000 islanders grumble ever more loudly as the garrison's ranks begin to thin. Apart from servicing the troops, they have little to do. There is hardly any manufacturing other than liquor production and a factory that converts old bits of military ordinance into knives for tourists. The local government has done its best to liven the place up, recently sponsoring avant-garde artists to exhibit their works in disused military bunkers. But something is still missing: the mainland tourists.

China's initial response to the opening of the “mini three links” was lukewarm: sending tourists was seen as too much of a gift to President Chen. But late last year the mainland authorities announced that tourists could come, at least from Fujian province. The first group arrived on December 7th, though Taiwan is limiting numbers to 600 a day for now.

The island could be a huge attraction for mainlanders, 1,000 of whom already board boats every day simply to sail close and gawp at one of the giant slogans put up many years ago by Taiwanese troops: “Unite China with the Three Principles of the People”—the philosophy espoused by Sun Yat-sen and adopted by the KMT. If they set foot on Kinmen, however, they are in danger from poorly marked minefields if they stray off the roads, as your correspondent discovered after walking through one by mistake.

Since 2002, mainland tourists have been allowed to visit Taiwan proper, but Taiwan allows them in only if they arrive via a third country for which they have a visa. This restricts the flow to all but the very richest of mainlanders. Taiwan wants to develop its tourist industry, but is worried that opening Taiwan proper to mainland tourists will encourage illegal immigration and provide an easy way in for mainland secret agents. But Kinmen's top official, Lee Juh-feng, has no time for such

excuses. “In future we hope the majority of tourists (in Kinmen) will be from the mainland, not from Taiwan,” he says.

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Moving on

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Manufacturing is out, knowledge-based industries are in

Reuters

Anything to build a brand

AT THE start of this decade, three-quarters of the world's notebook computers were made in Taiwan. Now the last of the production lines—except for a few top-of-the-range models—are preparing to move to China. “Taiwan is no longer a manufacturing paradise,” says K.Y. Lee, the chairman and chief executive of BenQ Corporation, a Taiwanese maker of consumer electronics and mobile phones.

How can the island adapt? Many of its companies have prospered in the same way as BenQ, by making IT products for other companies which sell them under their own brands—a process known as original design manufacturing (ODM) or original equipment manufacturing (OEM), depending on the amount of creative work involved. But China is fast getting into the ODM business too. At the same time, consolidation among the brand-name IT producers has reduced the number of potential customers for the ODM manufacturers and intensified competition. “We think the company cannot rely on this sort of business in the long term,” says Mr Lee. “We must find a way out.”

In Taiwan, this requires a radical change in thinking. Although Taiwanese companies make a large proportion of the world's IT hardware, whether in Taiwan or on the mainland, few of the consumers who buy the products would recognise their names. What they see is the labels of other firms, often American, Japanese or South Korean. The island's IT manufacturers, whose output accounts for 15% of Taiwan's GDP, have concentrated on making goods as efficiently as possible rather than on branding and marketing. The top 100 global brands list drawn up by Interbrand, a consultancy, does not contain a single Taiwanese firm.

A few years ago, many in Taiwan feared that the exodus to the mainland of the island's anonymous industries would leave Taiwan with swelling ranks of unemployed workers. Their worries were intensified by the bursting of the IT bubble. In 2001, Taiwan's economy contracted by 2.2%, the first whole year of negative growth in half a century. Unemployment surged from 2.9% in 1999 to 5.2% in 2002.

But now Taiwan's economy is regaining strength. GDP growth in 2004 was around 5.9%, buoyed by strong private investment, and this year is expected to be 4-5%. The banking system, awash with bad loans three or four years ago, is looking far healthier. The non-performing loan ratio has fallen from 8.3% in 2001 to around 3.5%. Unemployment fell to below 4.5% last year. Despondency is giving way to visions of Taiwan as a centre of research and development (R&D), “knowledge-based” industries based on the exploitation of ideas, logistics and financial services, and globally recognised brands.

BenQ is among the first of Taiwan's big ODM firms (its turnover in 2003 was $3.2 billion) to try building a brand. Since 2001, when it was spun off from its parent, Acer, BenQ has expanded its branded operations from around a quarter of its business to 35-40%. Acer, the world's fifth-biggest producer of personal computers, has made notable gains in developing its brand too. Acer notebook computers are now among the top sellers in Europe.

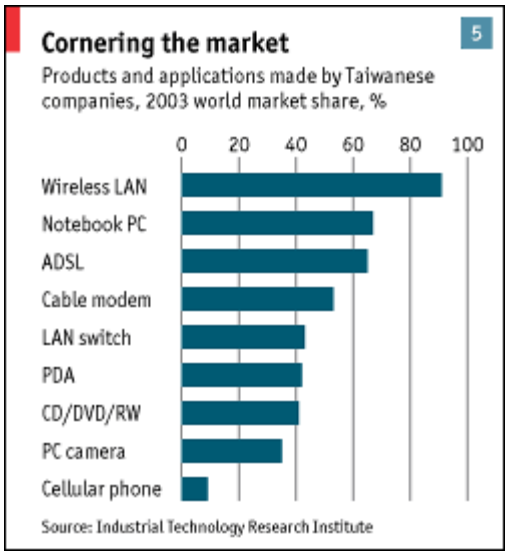
For BenQ, the transition involves risks, not least that buyers of their ODM equipment might turn to other suppliers because the new brand might compete with the ODM product. As Taiwan's biggest manufacturer of mobile phones, it is trying to build up its own brand, but continues to sell mobile phones to Motorola, which has nearly half of Taiwan's market.

Mr Lee says his company has managed to steer clear of potential conflicts by making its branded models clearly different from those supplied to ODM customers. Profit margins on branded business are three or four percentage points higher than on ODM output, he says. BenQ spends far more on R&D than traditional ODM manufacturers: around 3% of its revenue, against an average of around 1%.

For large, well-established companies such as BenQ and Acer, developing their own brands may be feasible. But the backbone of Taiwan's industry consists of small and medium-sized enterprises that are looking for short-term profits. In their race to drive down costs, R&D is an unaffordable luxury. So Taiwan's government has long seen it as its business to help steer industry in new directions. Two years ago it unveiled a development plan known as “Challenge 2008”, which emphasised the need to build brands and concentrate on cutting-edge technologies. It called for an increase in total R&D spending from just over 2% of GDP to 3% within six years. This would bring Taiwan up to the current level of the United States and Japan. The government would do its bit by providing low-interest loans and launching new transport infrastructure projects.

The industries Taiwan hopes to boost are intriguingly known as the “two trillions and the twin stars”. The two trillions refer to the semiconductor and the thin-film transistor liquid crystal display (TFT LCD) flat-screen industries, annual output of which is supposed to more than double by 2006, to more than 1 trillion Taiwanese dollars ($30 billion) each. The twin stars refer to digital content (such as digital games and computer animation) and biotechnology, which are expected to grow at similar rates.

Taiwanese industry is well on its way to accomplishing some of these goals. The flat-screen industry has grown rapidly, thanks to the nimbleness of Taiwanese business rather than government support. Taiwan now matches the market share of rival South Korea and could well surpass it in the coming year.



Going, going

Taiwanese officials know they have little hope of keeping their most treasured industries entirely on the island. China's growing domestic market for IT products is pushing Taiwanese companies to move closer to their consumers. In the TFT LCD business, manufacturers have been pressing the government to allow them to move the (labour-intensive) production of the small screens used in mobile phones to the mainland. Joseph Wu, the head of Taiwan's Mainland Affairs Council, says that after initial hesitation, restrictions on small screens are now likely to be eased.

For all the push to the mainland, businesses still prefer to keep their latest technologies and cutting-edge R&D in Taiwan. Intellectual property rights (IPR) protection on the island has improved considerably in recent years, not least thanks to pressure from America. Although owners of intellectual properties still complain, Taiwan is certainly a far safer place for them than the mainland.

But for Taiwan to fulfil its dreams, it will need to open wider to China. It is already suffering a growing shortage of the highly skilled workers needed for its new industries. A freer flow of workers, facilitated by direct flights, would turn an already dynamic economic relationship “red hot”, says Richard Vuylsteke, director of the American Chamber of Commerce in Taipei. Among other things, it would encourage multinational investors to see Taiwan as a back door to doing business in China, a role that the island has long aspired to play. “If Taiwan continues to view the mainland through the prism of economic threat, it is in danger of isolating itself and getting cut out of tomorrow's deals,” said America's chief representative on the island, Douglas Paal, in a 2002 speech.

Restrictions on cross-strait investment hamper Taiwan's efforts to build up its service industries. They block Taiwanese banks, for example, from doing any more than set up representative offices on the mainland or remitting money to Taiwanese firms or individuals in China. In the semiconductor industry, they hobble investment in chip-fabrication plants using 8-inch wafer technology, even though China itself is setting up production lines using the latest 12-inch technology.

Both China and Taiwan are members of the World Trade Organisation (WTO), but Taiwan still bars imports of a wide range of mainland goods, from agricultural products to cars. Chinese investment in Taiwan is all but banned (though there are ways round that). Protectionist sentiment on the island is strong. “Even though [Taiwan is] a market economy, when we face such a hostile and strong neighbour, we need to take some precautions,” says Mr Wu of the Mainland Affairs Council.

The KMT has promised a very different approach to cross-strait ties. The party's chairman, Lien Chan, says he wants a free-trade agreement and eventually a full-fledged common market with the mainland. A free-trade agreement would allay Taiwanese worries about exclusion from a mooted free-trade area embracing the 10-member Association of South-East Asian Nations (ASEAN), China, Japan and South Korea. Mr Lardy of the Institute for International Economics says that if such a regional arrangement went ahead, the island would lose out in a big way. The problem is how to get China to talk.

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My fab is bigger than yours

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A cross-strait chip-making competition

THE citizenship of Semiconductor Manufacturing International Corporation (SMIC) is hard to establish. Registered in the Cayman Islands, the company has its headquarters in Shanghai; its chairman and CEO is Taiwanese; the majority of its investment (he thinks) comes from America; its biggest shareholder is Chinese; and it is listed in both America and Hong Kong. But the main point is that to China it is Chinese, and to Taiwan it is simply menacing.

In the semiconductor industry, identity has an importance that transcends the value of silicon chips. Taiwan is immensely proud of its global leadership in the sector. Not many people outside the business may have heard of the Taiwanese giants, Taiwan Semiconductor Manufacturing (TSMC) and United Microelectronics (UMC), but these two (definitely Taiwanese) companies between them account for around 70% of the world's foundry production (a foundry is a semiconductor manufacturer that produces chips for other brands). They symbolise Taiwan's transformation from a maker of cheap plastic toys 25 years ago to a manufacturer of leading technologies. They even have a strategic dimension. In his 2001 book, “Silicon Shield”, Craig Addison, a Hong Kong-based consultant, argues that Taiwan's role in the IT industry has become crucial to the global economy, so America would defend the island against attack.

Enter SMIC (usually pronounced “smick”), founded in 2000 by Richard Chang after he sold his Taiwanese company, Worldwide Semiconductor Manufacturing, to TSMC. Shanghai Industrial Holdings, a Hong Kong-listed company controlled by the Shanghai government, became SMIC's biggest single shareholder. SMIC's listings in 2004 in Hong Kong and New York raised more than $1 billion. The company is about to become the world's third-biggest foundry.

But what worried Taiwan most was the opening in September 2004 of SMIC's state-of-the-art fabrication plant (or fab, in the industry parlance) using 12-inch wafer technology. Taiwanese companies are still barred by their government from investing in 12-inch fabs on the mainland, and can invest in 8-inch fabs (the next step down) there only if they already have a 12-inch fab in Taiwan and ship their old 8-inch equipment to the mainland. SMIC was able to buy 12-inch equipment from private western firms, with a promise not to produce chips for Chinese military use.

Taiwanese officials are now belatedly discussing an end to the ban on 12-inch fab investment. Ho Mei-yueh, the economics minister, says there is no need to restrict technologies that China already has, but it is very important that Taiwan stay two generations of technology ahead of China.

The mood in Taiwan is still bitter. TSMC has filed a lawsuit against SMIC, accusing it of stealing the Taiwanese company's intellectual property, which SMIC denies. Mr Chang, meanwhile, magnanimously welcomes his competitors. He sees a vast potential market in China. “People ask, ‘Richard, are you crazy? Are you inviting in the competition?' [But I say] when the pie is big enough, the competition is very friendly,” he explains.

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Separate ways

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But the two neighbours must play it softly

Let fortune smile

THE curators of China's national museum in Beijing are wondering what to do with a three-metre high cylindrical copper container donated by a famous state-owned distillery in 2001. Inside it are 34 bottles of Chinese grain liquor, each representing one of what China regards as its regions—including Taiwan. The 2.3-tonne object is inscribed with the words: “Precious celebratory bottles for the unification of the motherland”. The museum originally put it on display in the main hall, but it got in the way and last year was moved out into a courtyard off limits to the public. With a big refurbishment now under way, officials seem rather embarrassed by it.

Chinese and American leaders would probably like to see the Taiwan problem similarly put to one side. But the Taiwanese leaders' growing impatience for recognition is forcing China and America to respond. In the past, America has always shunned the role of mediator between China and Taiwan. But now it is getting anxious to move things along.

“We are interested in hearing from the two sides if they think there's a role for [America] that would be acceptable to both sides. And increasingly both come to us and suggest that perhaps there is a role,” says a senior State Department official. If both sides wanted America to facilitate a dialogue, “it is something we would give consideration to,” he says. But “they haven't quite come up with a blueprint for what might work for everybody.”

That is putting it mildly. Since the late 1990s, there has been no official contact of any kind between China and Taiwan. China cannot bring itself even to talk about talks with Mr Chen. When a Taiwanese academic chosen to represent the island at a summit of Asia-Pacific leaders last November actually shook hands and had a brief chat with China's president, Hu Jintao, there was a frisson of excitement in Taiwan. But it soon fizzled out. In December China threatened to pass a new law against secession to keep Taiwan in check.

Some American academics think there might be scope for an interim agreement. This would involve Taiwan pledging not to declare de jure independence and China promising not to attack Taiwan for a specified period, say 20-30 years. During this period they would work on things like arrangements for cross-strait transport and building trust between their respective armed forces. Taiwan would be given more freedom to join international bodies.

A suggestion along these lines was put forward in early 2004 by a former senior official in President Clinton's National Security Council, Kenneth Lieberthal, and another China expert, David Lampton. Officials in China and Taiwan listened politely, but they remain just as far from the negotiating table. China still insists that any talks be held on the basis that there is only one China, of which Taiwan is a part. President Chen says that to accept this would be tantamount to surrender. His only hint of compromise has been to say that he would be prepared to resume talks on the same basis as the two sides' sporadic discussions in the 1990s, which in China's view did involve an understanding on “one China”. But President Chen seems so utterly opposed to China's own idea of one China that his big neighbour does not trust him.

The Americans say there is not much they can do. According to a story told in Washington, when a senior State Department official suggested in 1999 that China adopt a “one country, three systems” policy to deal with Taiwan, Chinese diplomats thought that was not a bad idea—except that it had come from an American. Both sides, but especially China, would be deeply suspicious of any plan pushed by America.

It is widely accepted that an interim agreement putting aside questions of sovereignty would be a good thing. But China would need considerable political courage to stop insisting (even temporarily) that Taiwan accept it is part of China (even if loosely defined). The new leaders in Beijing are showing no signs of such courage. If China were to shelve the issue, it could not be sure that it would ever be able to revive it.

More likely in the years ahead is a kind of detente by default, with agreements on smaller, more concrete, issues gradually helping to build up mutual confidence. Taiwan says it wants to build a bridge between Kinmen and the mainland. If it can persuade China to agree, such a joint project would be of enormous symbolic importance.

Borrowing the term South Korea uses for its effort to lure North Korea out of its shell, President Chen said in November that he would adopt a “sunshine policy” toward the mainland. He thinks that an agreement could be reached on chartered flights for cargo, as well as for passengers for the lunar new year celebrations. This would be a good start. Bonnie Glaser of the Centre for Strategic and International Studies in Washington says achieving agreement on the three links first would buy time and help create stability in the cross-strait relationship.

If only China felt the need. Its biggest incentive might be the international kudos that China would gain for restoring stability. If the Olympic Games in Beijing in 2008 were held against a background of rapprochement across the strait, that would greatly assist China's efforts to project itself as a responsible world power. China could wriggle out of the straitjacket of its own rhetoric by accepting that even a move to formal independence by the island would make no difference if no major country recognised it—and the likelihood is that none would. But the Communist Party still seems to feel that the damage this would inflict on its domestic credibility would outweigh the benefits.

Close enough

Ultimately, China will have to come to terms with Taiwan's permanent separation. The most it can ever realistically hope for—even if a liberal democracy were to take root on the mainland—is an

arrangement along the lines of the European Union that preserves separate sovereignties. Taiwan would not want to get any closer.

There is a glimmer of hope that China is beginning to understand Taiwan's determination not to be unified. Its “one country, two systems” idea, which in effect puts Taiwan in the same category as Hong Kong, is no longer pushed quite as aggressively as before. One of China's most authoritative pronouncements on Taiwan policy in recent years, issued on May 17th 2004, did not mention “one country, two systems” and only touched on reunification. It concentrated on the dangers of formal separation rather than railing against Taiwan's de facto independence.

But China's President Hu Jintao, who took over as chief of the armed forces in September 2004, would see no domestic benefit in appearing weak on issues of national sovereignty. Nor is there much prospect of change in Taiwan as long as a generation still embittered by the KMT's repressive rule remains in power. “For the decade ahead, we need to keep the lid on the pressure cooker,” says an American official. Fortunately, such a policy will be strongly underpinned by mutual economic advantage.

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Sources and Acknowledgments

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Consumer electronics

Crunch time for Apple

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AP

Building on the phenomenal success of the iPod, Apple's Steve Jobs is having another go at the mass market for computers

EVERY January, Steve Jobs, the chief executive of Apple Computer, manages to look like the hippest boss in his industry. During the first week of the year, he coolly stands aside as all the other computer and consumer-electronics industry bosses go to Las Vegas to exhaust themselves and their audiences at the Consumer Electronics Show, a huge and unwieldy event with probably the world's worst taxi queue. Then, in the second week, Mr Jobs (pictured), in his trademark black mock-turtleneck and jeans, mounts a stage in San Francisco at Apple's MacWorld conference, a sort of Woodstock or Glastonbury of the gadget world. There, to oohs and aahs, he unveils Apple's latest products, all inevitably stunning in their design elegance and user-friendliness, not least when compared with the contraptions his rivals exhibited the week before.

But this week Mr Jobs went a subtle but dramatic step further than in past years. Visibly emboldened by the runaway success of the iPod, Apple's iconic portable music player, and by profits in the most recent quarter that were up by 368% on the same quarter a year earlier, he announced what is, in effect, a new corporate strategy. Instead of settling for being a niche player selling beautiful but expensive computers and related gadgets to a cultish few, the firm is returning to contest the mass market that it long ago ceded to Microsoft, Dell and others.

That this challenge (in effect, a rematch with Mr Jobs's nemesis, Microsoft's Bill Gates) is even

conceivable is due entirely to the iPod, which is going from strength to strength. In December, Apple shipped the ten millionth, having sold 4.5m during this past holiday season alone. The iPod's market share has grown from about one-third to two-thirds in the past year, at the expense of cheaper “flash” players (iPods use hard disks to store music, rather than flash-memory cards). This is a vindication of Mr Jobs's decision a year ago to offer the iPod mini, a smaller and less expensive model.

An Apple for everyone

But Mr Jobs wants to attack even that remaining third of the market. This week, he unveiled the iPod Shuffle, a flash player that costs $99 (with capacity for 120 songs) or $149 (240 songs). It is the size of a pack of chewing gum, and looks (of course) much cooler than any other flash player. And a deal with Motorola, a maker of mobile phones, to include iPod-like music-player software on some handsets, starting this spring, should attract even more users. For Mr Jobs, who has never previously dabbled at the bottom of—nor explicitly attempted to dominate—any market, all this is unprecedented.

It also makes perfect sense, says Steven Milunovich, analyst at Merrill Lynch, as long as one realises that “the iPod is the tail wagging the dog”, the dog being Apple's computer business. Even though the iPod now outsells Apple's computers by volume, most of the firm's revenues still come from the computers—the iMac desktop, the iBook laptop, and the high-end Power Mac and PowerBook. So Mr Jobs still needs to fix Apple's long-standing problem in its core business, which is that its global market share in computers seems stuck at about 3%. Using the iPod's “halo effect” to convert mainstream (ie, Microsoft Windows) computer users, thinks Mr Milunovich, is the way to do it.

This is why Mr Jobs, to gasps in the audience (even though the news had already leaked out), also announced his most radical product, the Mac mini. Named to remind people of the iPod mini, this is a fully-fledged but tiny computer—it almost fit into Mr Jobs's palm. The twist, in Mr Jobs's words, is that it is BYODKM, or “bring your own display, keyboard and mouse”. Buyers are expected to plug in whatever monitors and peripherals they have already. Leaving out these bits reduces the price to $499, or $599 for a more powerful model. This is about $800 less than the flagship iMac, making the Mac mini Apple's first truly low-cost computer, “so that people who are thinking of switching [from a Windows machine] will have no excuse,” says Mr Jobs.

Cutting the price tag of the new box by leaving out the peripherals, instead of by stripping down its functionality, is a shrewd way of minimising two risks. It is unlikely to cannibalise the sales and profit margins of Apple's more expensive models; and it is likely to snap many Windows users out of their inertia and into making the switch. As more of them do, Mr Jobs reckons, the converts will tell other Windows users how safe Macs are (compared with Microsoft's buggy, virus-prone software) and how user-friendly (just try networking several Macs together, compared with several Windows machines).

Thus, Mr Jobs hopes, Apple's growing but seamlessly integrated range of products, from entry-level stuff for kids to pricey boxes for professional designers or musicians, should make Apple the most revered brand in the digital home and in consumer electronics. This is why Mr Jobs has opened 101 retail stores around the world, their locations hand-picked by a former Gap manager. It also helps that an ecosystem of accessories—over 400 for the iPod alone—is blooming. Mr Jobs announced this week, for instance, that Mercedes, Nissan, Volvo, Scion, Alfa Romeo and Ferrari will join BMW and offer iPod controls in their steering wheels. And it helps that Mr Jobs, also the boss of Pixar, a hugely successful animated-film studio, understands the world of entertainment better than probably any other boss in his industry.

One of the people who might beg to differ is Mr Gates. Fatefully, in the 1980s, he chose to license Microsoft's operating system to many hardware-makers, thus making it a standard and consigning Apple, which insisted on bundling its superior software and hardware together, to the margins. Apple revived only after Mr Jobs, who was ousted in 1985, returned in 1996. There are echoes today. Apple leads the market for online music with iTunes, its music store and jukebox software, which works only with the iPod, whereas Microsoft is pushing a rival software format, Windows Media, to several online music stores and hardware-makers in an attempt to make it the industry standard.

Mr Gates could come from behind once again. On the other hand, Mr Jobs has been more circumspect this time around—designing iTunes to work with Windows, for instance, doing marketing deals for the iPod with Hewlett-Packard and Motorola, and, with this week's announcements, fending off competition from lower-cost rivals. It is too early to tell which of these two generals is still fighting the last war.

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America's car industry

Raw nerves in Motown

Jan 13th 2005 | DETROIT
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Making money remains tough for America's big three carmakers

Get article background

AP

Hard to beat

THE doors to Detroit's annual car show had barely opened to the public this week before the gloom set in. One local newspaper said that General Motors (GM) would make huge cuts to its American workforce this year. GM officials said that the paper had got its facts wrong, but admitted that about 8,000 jobs would go, largely through attrition, however, it said, rather than layoffs.

Then David Cole, the respected head of the Centre for Automotive Research, suggested that one of the "big three" American carmakers could go bust. Even after a year of strong vehicle sales, relentless price-cutting has sapped Detroit's profitability. Health-care costs are mounting. Over-capacity is growing. That Mr Cole, usually a Detroit booster (and son of a former GM president, to boot), could evoke such a sombre scenario was chilling.

European and Asian producers now largely dominate the luxury segment of America's car market. The increasingly bold and innovative South Koreans are attacking the market for cheaper cars. More worrying for GM, Ford and Chrysler—the big three—was that the show was awash with new Japanese light trucks, such as the Honda Ridgeline pick-up. These are aimed at the only segment still dominated by Detroit. Last year American carmakers saw their domestic market share drop to record lows, while that of Asian competitors rose above 30% for the first time.

Breaking into the light-truck segment—the niche where American buyers are most loyal—is not easy for the Asian firms, as Toyota discovered with its poorly received Tundra pick-up. Last year Ford set a new record, selling over 925,000 of its full-size F-Series pick-ups. But the Japanese do not give up easily and last year captured around one-quarter of the light-truck market. That means shrinking profit margins for Detroit, and bigger discounts. One Chevrolet dealer, struggling to clear unsold Silverado pick-ups, has offered a free Chevy Aveo minicar with each truck.

One reason for the (belated) success of Japanese firms in light trucks is their effort to promote themselves as "domestic". Last year, Nissan sold 985,000 vehicles in America—and built 950,000 of them in Tennessee and Mississippi. Toyota's TV ads stress the billions of dollars it has invested in America and the size of its American payroll.

Faced with this, it was hardly surprising that GM's chairman, Rick Wagoner, could manage only a strained smile when he posed in front of the Sequel, a prototype fuel-cell vehicle. The hydrogen-powered car, he said, would put GM at the forefront of automotive technology. But few expect the technology to be ready for mass production soon. Meanwhile, GM must contend with the crushing burden of health-care costs for current and retired workers: $4 billion a year, roughly $2,000 for each vehicle it makes in America.

Still, at least Detroit's bosses have been doing some intensive housecleaning: closing plants, shedding surplus workers and making big gains in productivity. Little things matter, such as the way that GM has trimmed the cost of creating tools and dies by about two-thirds. Without its health-care costs, GM would show decent profits in its North American business.

One bright sign is the nascent recovery at Chrysler, which, until recently, seemed the weakest of the big three. Its Ontario plant is struggling to keep up with demand for its 300 saloon, and a third shift is being added. This car won the top award at the show—an honour that in recent years has routinely gone to a foreign brand. It is now America that is propping up Chrysler's parent, DaimlerChrysler, as it works to reduce costs and quality snags at its Mercedes-Benz division, in Germany.

Ford thinks that it can make a $6 billion annual profit by the middle of this decade. It got a good reception for its new Five Hundred sedan and Freestyle “crossover” (a car/sport-utility combo). Ford's Escape Hybrid, the first gasoline-electric hybrid sport-utility vehicle on the market, took the truck-of-the-year prize.

Until now, Japanese carmakers have been dominant in the relatively clean, fuel-efficient sorts of technology. Waiting lists grew for Toyota's Prius last year as petrol prices soared to $3 a gallon in California. But all the hybrid-electric vehicles sold in America last year made up barely 1% of the market, and may not get much above 3% before the end of the decade, says J.D. Power, a market research firm. “We forgot the emotional impact and the fact that a lot of people out there want to make an environmental statement,” said GM's vice-chairman, Bob Lutz, whose firm is now playing hybrid catch-up.

Making a business case for the technologically complex hybrids is a problem for all, not least because the sales volumes are so low. But big-volume vehicles, such as Ford's F-Series, are becoming the exception. In 1947, there were 47 models of car on American roads. This year, there will be 251, says AutoPacific, a consultancy. Ford could once expect to sell nearly 400,000 a year of its Taurus saloon. But not even optimists put likely yearly sales of the Five Hundred much beyond 100,000.

This is typical of a mature consumer-goods market faced with over-capacity: everyone tries to stand out in the crowd by targeting ever narrower slices of the market. Yet it threatens to undermine the economies of scale on which the car industry is built. So carmakers are increasing variety by sharing some basic parts between models, while hoping for an occasional winner. But even if Detroit still comes up with occasional hits, the big three may never again dominate as they once did.

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GM crops

Trade trouble ahead

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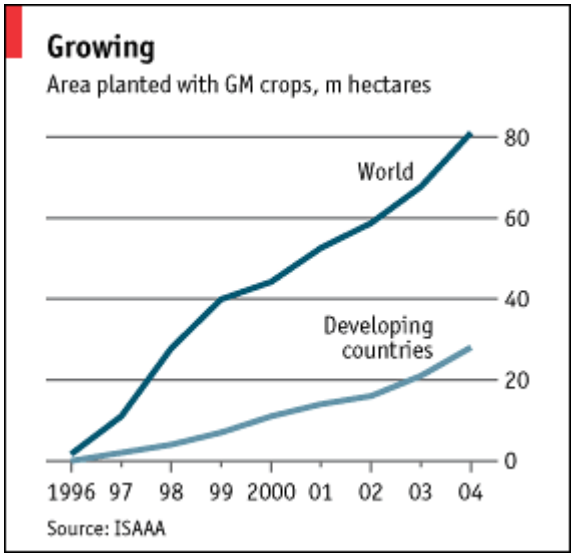
The fast spread of genetically modified crops means transatlantic trouble



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GREENS may hate them, but farmers love them: that is the lesson of statistics out this week on the spread of genetically modified (GM) crops. The area sown with them worldwide last year was up by a startling 20% on 2003, to 81m hectares.

So says the ISAAA (a pro-GM body but the best source of data there is). After an 11% rise, America still accounts for nearly 60% of the total, but GM areas in other big food exporters, bar Australia, were rising fast: in Argentina by 17%, Canada by 23%, Brazil by 66% (maybe: no one can be sure how much of its soya is GM, but certainly plenty and the potential there is huge). Maize and soya remain by far the biggest GM food crops. Wheat has got nowhere. China, though it has rushed into GM cotton, is still dithering about GM rice.

What does the rise of GM mean for business? For specialists in GM seeds such as Monsanto or its European rival Syngenta, very good news. Monsanto has just released quarterly results showing its herbicide sales flat but its seeds business 20% up; after a rough period, the firm is now heading back into profit. But there may be trade trouble ahead. The European Union (EU), whose consumers mostly fear GM, is already under fire from America, Canada and Argentina for its past ban on their GM exports. And though the ban has gone and the EU recently approved some GM varieties of maize, its new GM rules look—from the prairies—just as obstructive, and its national governments, with their voters in mind, are mostly dragging their feet.

Yet the EU has a fifth column inside: Spain plants a small but rapidly increasing area with GM maize and Romania, which is likely to join the EU in 2007, grows GM soya.

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Tsunami relief

Companies chip in

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An outbreak of corporate charity

FIRMS worldwide—or, rather, their shareholders—are pouring money into tsunami relief. The big questions for them are: how much and in what form? The question “why?” seems to have been answered pretty easily: like individuals and governments around the world, many firms have been shaken into giving by the sheer scale of the disaster.

A few big donations have made headlines: $10m promised by Coca-Cola and by Pfizer; $7.5m by Deutsche Bank and by Bayer; nearly $6m by BP; $5m by Dow and by Exxon Mobil; $4m by Toyota; $3m by the Hong Kong tycoon Li Ka-shing and his Hutchison Whampoa empire, with more to come from local subsidiaries; $2m or so by ThyssenKrupp, Zurich Financial and Vodafone; $1m or so by Alcatel, Allianz and others, not least Sinopec, a big Chinese oil company.

Even given their size, American firms (whose donations are tax-deductible) look to have been generous, European and Japanese ones (except Toyota) less so. Among individual industries, “big pharma” has led the field, with cash sums, besides Pfizer's and Bayer's, of $4m apiece from Bristol-Myers and GlaxoSmithKline, and smaller ones from Abbott Laboratories, Merck, Johnson & Johnson and most other names that count, European or American.

But no meaningful “league table” can be drawn up. Giving or pledging is still going on. Often not even the corporate CFO can yet know what it will amount to, since many firms have said that—on top of a fixed sum or not—they will match employee contributions. This is simple, and has obvious merits: “you give, we'll give” is a fair answer to any employees inclined to accuse the bosses of playing Scrooge.

India's Tata Group is urging its constituents to give “substantially” more than employees; Computer Associates, of New York, says it will give twice as much. In some firms, employees have been asked (not always too politely, in one or two Chinese cases, it is said) to give a day's pay, which the firm will match. SAS, the Scandinavian airline, is collecting in its planes and waiting rooms and at its counters, and will match the result.

To multiply uncertainty, in or on top of many of the sums publicised comes aid in kind. Pfizer's big cash pledge, for instance, is dwarfed by the $25m worth of medications that it has also promised; Johnson & Johnson says that it has similarly added $81m to its $2m in cash. Drugs are notoriously worth whatever somebody says they are (cost? sales value? and if so, in what market? and would that volume have been sold anyway?). Honest estimates can differ widely.

That is true of most aid in kind, be it goods or services. The logistics firms DHL and TNT are providing transport in or to the disaster region. In India, while ICICI Bank and the Life Insurance Corporation have each promised over $1m, the Confederation of Indian Industry has rallied its members to join it in setting up centres to collect aid money and materials, and others to

distribute the results. Some are sending doctors or engineers to do relief work, or managers to run it. The “real” cost to the donors of such aid, let alone its value to the recipients, cannot be sensibly calculated.

In contrast, firms from outside the region are mostly sticking to cash. Not all: British Telecom has sent engineers to help in Indonesia. But most recognise that deciding what goods to send where and how is best left to the experts in disaster relief and people on the spot.

Why so much for this particular cause? That is a question, given how carefully companies usually limit and aim their giving. Is it just public relations? In part, yes. HSBC, a British-based bank that will donate up to $2m, has sizeable operations in Sri Lanka. It aims to be part of the community and, as an Asian spokesman says, “if you're perceived to have behaved badly, there's a price to pay.” Many firms would echo this. In drugs, there has plainly been competition. In Australia firms have been under real pressure: too much, indeed, laments the boss of one big bank there, and one Australian shareholder organisation has said that boards have no business handing out shareholders' cash.

Yet many firms with no links to the tsunami-hit countries, and under no peer pressure, are giving too. Why? “Something this big,” says Highmark, a Pittsburgh health insurer, “you just have to.”

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Digital convergence

TV on your phone

Jan 13th 2005
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Both fixed and mobile telecoms operators are getting into television

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Reuters

Ideal for desperate housewives

IN RECENT years the mobile phone has turned into an electronic jack-of-all-trades, the remote control for everyday life, a digital equivalent of the Swiss Army knife. A modern handset can function as a digital camera, music player, radio, games console and messaging device, as well as being a phone. On January 10th, trials began in South Korea of a new service that incorporates yet another device into the handset: television. TU Media, a joint venture between SK Telecom and Toshiba, a Japanese electronics firm, began beaming three of a planned 12 mobile-TV channels to special handsets, a service for which it plans to charge subscribers $11 a month. In Europe and America, meanwhile, Nokia, the world's leading handset-maker, is also testing mobile TV services: the most elaborate trial so far, with 500 users, will start soon in the English city of Oxford, in conjunction with O2, a European operator.

It is not just mobile operators that are suddenly interested in TV. Incumbent fixed-line operators such as Verizon, SBC and BellSouth in America, BT in Britain and Deutsche Telekom in Germany are getting into it, too, with delivery via high-speed DSL (digital) phone lines or new, purpose-built fibre-optic networks. Why?

For fixed-line operators, the need to offer TV is clear. Many of them face stiff competition from cable-TV firms, which can offer the “triple play” of TV, broadband internet and telephony over their networks. This week Comcast, America's biggest cable firm, announced an ambitious plan to offer phone service to all subscribers by the end of 2006. Bundling together TV, broadband and phone increases customer loyalty (since it is harder to switch) and lets cable operators achieve economies of scale in billing and marketing.

“The cable companies are entering the telephony market, so the telecoms providers have got to do something,” says Andrew Cole, of A.T. Kearney, a consultancy. In some countries, including France, Italy, Britain and Japan, incumbent operators also face competition from insurgent operators (Iliad, FastWeb, HomeChoice and Yahoo! BB) offering triple-play bundles over high-speed phone lines.

To compete, the incumbents need to get into TV too. “TV is no longer optional,” says Ford Cavallari, of Adventis, a consultancy. “If they don't do it, someone else is going to.” The fastest way into the TV business, he says, is to ally with a satellite-TV firm and resell its services—as SBC

has done with EchoStar, for example. That is an interim measure until operators are able to deliver TV via DSL, or via a combination of DSL and new fibre-optic networks. Operators around the world are now upgrading their networks and laying new fibre with TV services in mind.

Mobile operators, in contrast, see TV as a “nice to have” rather than a “must have” service. Technical trials have shown that mobile TV is possible. Market research suggests that consumers might pay up to €12 ($16) per month for it, says Carolina Milanesi of Gartner, a consultancy. Unlike complex 3G data services, which are proving to be a hard sell, mobile TV could have mass appeal. “Everyone gets it if you say ‘mobile TV',” says Richard Sharp, at Nokia's multimedia division.

While a combination of satellite and ground-based transmission is being used in South Korea, Nokia is promoting a new terrestrial mobile-TV standard, called DVB-H. One possible business model, says Mr Sharp, is for mobile operators to share a national DVB-H network, carrying both common and operator-specific channels. Operators would thus share costs while retaining the ability to differentiate themselves through exclusive content deals. Yet a lack of suitable spectrum is one problem; another is gaining the appropriate rights from content providers. So far, mobile operators think that content means ringtones and screen logos, notes Ms Milanesi.

Fixed-line operators face a similar problem, since they too may lack relationships with content providers. The obvious pairings, says Mr Cole, are for fixed-line operators to pair off with satellite-TV firms in order to gain “media competence”; and for cable-TV operators to pair off with stand-alone mobile operators. “There is going to be a tremendous amount of turbulence, driven by the convergence of telecoms, television and media,” he says. As digital technology erodes the barriers between previously distinct industries, continuing convergence—both of services and of firms—now seems inevitable.

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Advertising

Bolloré's bet

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A corporate raider targets Havas, a big French advertising agency

IN FRANCE'S clubby business circles Vincent Bolloré is a controversial figure. One-third of the establishment loathes him, one-third does not trust him and another third supports him, claims the boss of one big French company. A business leader's opinion of the country's top corporate raider depends on whether he has been, or could become, a victim of one of Mr Bolloré's raids. Those safe from his adventures admire his *sang froid* in sniffing out undervalued companies, shaking up management and extracting cash.

Mr Bolloré's latest target is Havas, a big French advertising agency. Last July, Mr Bolloré, on holiday on his boat, telephoned Alain de Pouzilhac, boss of Havas, to tell him that he would buy as much as 5% of the firm's shares, which he considered undervalued by the stockmarket. Mr de Pouzilhac welcomed this plan. Havas was trying to recover from one of the worst years in its history; interest from a well-known investor seemed to be good news.

But Mr de Pouzilhac soon grew suspicious of Mr Bolloré's true intentions, after Mr Bolloré confused him with contradictory statements about his investment in Havas. The turning point was last year's long bidding battle for Grey Global, a big American ad firm. Mr de Pouzilhac pulled out all the stops to acquire Grey, which would have strengthened Havas, then a weak number six in a consolidating global industry. When he tried to discuss a bid for Grey last September, his biggest shareholder seemed not to be interested. Yet a few days later Mr Bolloré leaked to the press that he opposed a takeover of Grey. In the end Britain's WPP, the world's largest advertising group, snapped up Grey.

Since then Mr de Pouzilhac and Mr Bolloré have not been on speaking terms. Mr Bolloré has gradually acquired 20% of Havas. Mr de Pouzilhac, in turn, has written several letters asking Mr Bolloré to explain his intentions, but got no reply. They are now fighting via the press. Through press interviews Mr de Pouzilhac has learned that Mr Bolloré wants two seats on the board of Havas, thinks Havas should adopt a two-tier board structure and plans to impose Pierre Dauzier, an ex-boss of Havas, as head of a new supervisory board.

Mr Bolloré says he is building a media holding company around Havas. Last month he pooled his Havas shares, hitherto split among four subsidiaries, in Bolloré Médias Investissements, a new entity. He also used two-thirds of his Havas stake to raise a five-year €200m ($270m) loan from Société Générale, hinting that the money might buy more Havas shares.

Yet his record as a corporate raider suggests that he may not become a strategic long-term investor. His €5 billion conglomerate is a mix of businesses ranging from shipping and commodities to cigarette paper. Media fits in awkwardly. Moreover, he is said to need the €200m loan to buy out investors in his group.

Perhaps Mr Bolloré is acting on behalf of France's Publicis, the world's fourth-biggest ad agency. Maurice Lévy, boss of Publicis, is close to Alain Minc, a consultant who is now advising Mr Bolloré. However, clients rarely want their ad firm to work for their main rival, and Havas looks after Peugeot and Danone while Publicis works for Renault and Nestlé. Mr de Pouzilhac estimates that some €500m in revenue would disappear were Havas and Publicis to merge. Also, Publicis is still digesting its acquisition of Bcom3, an American agency—and Havas is a big company to swallow.

Mr Bolloré may have hoped to orchestrate a bidding war between WPP and Publicis. But WPP does not seem interested. So if Publicis also proves unwilling to buy Havas, Mr Bolloré may face a tough choice. He could try to buy the entire company and install his men at the top. But advertising is a people business and many talented people might jump ship along with Mr de Pouzilhac—and, probably, at least some clients. Alternatively, he could quietly sell off his stake. Although Havas shares jumped when he started to buy them, they are now at around the price he paid. Selling without a profit might be something of a blemish on his record as a raider.

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Shoprite

Africa's Wal-Mart heads east

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A South African retailer happily risks imperial overstretch

Who needs the real Wal-Mart?

WHAT makes an upstart South African food retailer think it can conquer the developing world? Barely two decades ago, Shoprite consisted of a few tatty stores in Cape Town. Now it is Africa's largest retailer, with over 700 shops in 16 countries. It began to move east by taking over a French retail chain in Madagascar and opening a huge store in Mauritius. Then in December, Whitey Basson, Shoprite's energetic Afrikaner boss, threw open the doors of his first shop in Mumbai, India.

Shoprite's expansion follows a pattern common to South African firms. Isolated under apartheid, it built up experience and capital. Once foreign ties were allowed after 1994, it rushed to new markets.

Unlike most foreign supermarkets in Africa, Shoprite targets mostly low and middle-income shoppers. They seem to have more disposable income than once thought. The company's strategy, like that of America's mighty Wal-Mart, is to pile high, sell cheap and keep opening new stores. It seems to work. Shoprite's seven stores in poverty-stricken Madagascar are doing well and more are planned. Shoprite expects shops outside South Africa to provide half its group revenue eventually.

Customers in Madagascar like the bright, bland, cool, spacious stores, which stock 8,500 different goods. In Antananarivo, the capital, poorer shoppers throng for bags of cheap rice and sugar next to better-dressed buyers of bottled water and yoghurt. At the cash registers, a man piles up bags of bloody meat as a woman waits to pay for a dainty square of chocolate.

There are risks in Shoprite's expansion. As new, small markets are tacked on to its empire, it risks overstretching an already messy structure. The firm has to deal with wildly different rules on

taxes, imports, health, employment and numerous other bureaucratic measures—as well as managing 63,000 staff who speak many different languages. Technology helps. Complicated shipping routes and sales are tracked by a satellite system. And Mr Basson makes frequent use of his personal jet: often even small problems require talking directly to ministers and presidents.

Tough health and language rules in Egypt force local sourcing of most goods for its stores there. Cultural differences matter everywhere. Before running Madagascar's chain of stores, one expatriate manager's only experience outside South Africa was as a soldier fighting in Angola. At first he found it hard to understand local tastes: jars of Marmite and Bovril did not sell well; porridge-based food did not tempt the rice-loving Malagasy.

Especially painful are volatile African currencies. Most products for Shoprite's empire used to be sourced in South Africa, but the soaring value of the rand (up by over 100% against the dollar in the past three years) meant that suppliers had to be found elsewhere. Profits in Madagascar slumped when the currency collapsed in 2004; now 60% of goods come from local suppliers. Zimbabwe's ruined economy and currency have all but wiped out the value of Shoprite's operations there.

Despite these tribulations Shoprite prospers. Profits rose by 16% last year. Its market capitalisation is $1.2 billion. This bodes well for the big step into India. Shoprite is one of the first foreign food-retailers to be let in by India's wary government. Its hypermarket in Mumbai is said to be the country's biggest. Mr Basson is drawn by the huge numbers of Indian customers thought to be hungry for new stores. For that, he is happy to shoulder the risks.

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Face value

The state of denial we're in

Jan 13th 2005
From The Economist print edition

Ten years on, Will Hutton is standing by his bestselling critique of British capitalism

"DID I get it wrong?" It takes a brave pundit to ask that question. So Will Hutton deserves credit for challenging himself and readers of his column in the *Observer* newspaper on January 9th to re-examine his bestselling critique of British capitalism, and try to decide whether it has stood the test of time. Much has changed, in Britain and elsewhere, since "The State We're In" was published in January 1995—and much of the change has been different from what Mr Hutton expected. Yet after (no doubt) many long hours of soul-searching, Mr Hutton has found that he is as convinced as ever of his "core analysis".

In essence, this analysis was that the increasingly market-oriented British model of capitalism was in trouble. It needed to be reformed in ways that, taking the best bits from the alternative models of capitalism, would reduce the power of short-termist shareholders and strengthen that of other "stakeholders" in companies, including workers and the state.

In 1995, British voters were preparing to bring to an end nearly two decades of Conservative Party rule. Their faith in the party's economic competence had been shattered by a deep recession, a series of corporate scandals and Britain's forced exit from Europe's exchange-rate mechanism, a forerunner of the euro. Mr Hutton's book caught the mood perfectly, especially among educated metropolitan sorts who had long hated the free-market rhetoric and reforms of the Thatcher and Major governments. Even the then opposition leader, Tony Blair, was impressed by the book—albeit only, as Mr Hutton notes ruefully, "for 10 days" after giving a speech based on it. Mr Hutton, in his own words, "changed from being another economics writer to someone the *Daily Telegraph* described as the most dangerous man in Britain". He profited, not just from huge book sales, but also by becoming (for four years) editor of the *Observer*.

In the event, the past ten years have been the best decade for British capitalism since (at least) the 1950s, when Harold Macmillan, the then prime minister, famously declared that the British had "never had it so good". GDP has grown each year, unemployment and inflation have been consistently low, incomes have risen—even at the bottom. And whereas in 1995 it was hard to think of one big British firm that was truly world class, today Vodafone, Tesco and BP lead a long and growing list.

The success of British capitalism is all the more striking when you consider the fate of the rival models of capitalism to which Mr Hutton unfavourably compared it. Japan was on course to become the world's biggest economy in 2005, he argued, thanks to its model based on the long-term co-operative relationships between its firms, banks, customers and workers, as well as the leadership given to business by the government. Alas, the Japanese economy has stagnated for most of the past decade. The state's role in the economy has come to be seen as largely negative. The *keiretsu* families of firms that tied together banks, firms and suppliers are loosening. Lifetime employment guarantees are disappearing. Above all, Japan's banking system—which Mr Hutton enthused about as he bashed British banks—has in effect gone bust and become a huge drag on

business.

Model misbehaviour

Mr Hutton was equally keen on Germany's consensus-based model of capitalism, with its long-term-focused banks and representation for workers on company boards. Germany's economy, too, has struggled ever since. Its banks are troubled, though not as much as Japan's, and are reducing their shareholdings in corporate Germany. The consensus between German bosses and workers is fast breaking down, as the bosses increasingly envy the freedom to manage enjoyed by their British counterparts.

Although it shares many of the short-termist stockmarket features of British capitalism, Mr Hutton was also more impressed by America's model of capitalism. Yet while the American economy has done even better than Britain's during the past decade, it has done so while exhibiting even more extreme short-termist behaviour than Britain's. This was exemplified by the stockmarket bubble—far bigger in America than elsewhere—and its aftermath. The short-termism of America and Britain may not actually be a good thing—Mr Hutton was right, and ahead of the game, to argue for better auditing and for institutional investors such as pension funds to devote more effort to corporate governance. But America's and Britain's relative success may indicate that financial short-termism is, on balance, less of a liability than a form of capitalism that is inflexible when faced with economic change (such as Germany's and Japan's), whether because of government rules or private arrangements.

Mr Hutton attributes the surprising (to him) success of British capitalism to two main factors. First, the efforts of the Labour government since 1997 to ease social tensions that might otherwise have impeded economic progress. This was surely never as big a risk as he feared. Second, that globalisation offered many parts of the British economy (notably in the service sector) opportunities that “could not be seen in 1994”. Well, maybe. But it seems odd of Mr Hutton to gloss over the fact that positioning Britain to benefit from globalisation was an explicit goal of those he criticised in “The State We're In”: advocates of the market-based reforms initiated by the Conservatives and (later) maintained, despite Mr Hutton's urgings, by Labour.

Will the British and American models of capitalism continue to outperform their German and Japanese counterparts in the coming decade? Will a new model triumph: Chinese capitalism, perhaps? What reforms to different models of capitalism might alter the outcome? While sticking to his core analysis, Mr Hutton has come to realise that “modern capitalism is an ever moving target: trying to understand it, and then making a compelling case for reform, is bloody difficult.” Quite so.

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Samsung Electronics

As good as it gets?

Jan 13th 2005 | SEOUL
From The Economist print edition

Getty Images

Can a leading consumer-electronics giant keep getting stronger?

IT HAS been a remarkable year for Samsung Electronics. Last weekend, the company was one of the stars at the giant consumer-electronics show in Las Vegas, where it unveiled a glittering array of new products. Among them was a notable first: a mobile phone that uses voice-recognition technology to convert speech into text messages, offering respite to people who find typing messages on their mobile's tiny keyboard frustrating. Another Samsung model automatically scans business cards and inserts the details into the user's address book.

Just as impressive is the fact that this week Samsung will announce record-breaking annual results, not just as South Korea's most profitable, but also as its most visible, company. Samsung has edged closer to its Japanese rival Sony as the world's leading consumer-electronics firm. It is already the largest producer of many digital devices. It is poised to overtake America's Motorola as the world's second-biggest maker of mobile phones.

Yet even as Samsung was closing the books on a triumphant 2004, its future was looking less certain. The Korean won soared to a seven-year high against the dollar, reducing the value of much of its overseas earnings. While electronic gadgets such as digital cameras, mobile phones and flat-screen televisions remain as popular as ever, prices are falling. That cuts into Samsung's profit margins. Worst of all, the company's memory-chip business, by far its most profitable operation in 2004, is facing harder times as the notoriously cyclical semiconductor industry enters yet another downturn.

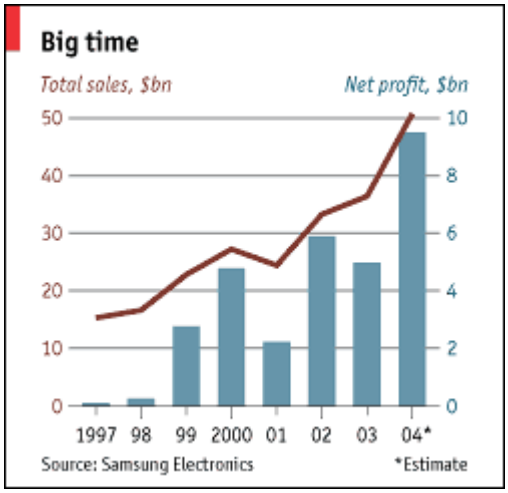
For Samsung's bosses, this may seem dishearteningly familiar. In 1995 the company also

smashed earnings records, only to see chip prices tumble and currencies head into turmoil. By the dark days of the 1997 Asian economic crisis, Samsung was deep in debt and heading towards bankruptcy. But this time things should be different. The company has now been transformed in so many ways, maintains Yun Jong-yong, a company veteran who took over as chief executive in 1996, that it can not only weather the coming storm, but will sail on to even greater things.

Mr Yun has to plot an ambitious course. The company's strategy is based on providing leading-edge, stylish products that can be sold for a premium. “If we were to compete only on price,” admits one executive, “the Chinese would slaughter us.”

So far, the strategy has paid off handsomely. Boosted by margins of more than 40% on semiconductors in the second quarter of 2004, Samsung Electronics' profits began to rise rapidly. By the third quarter, the company's net profit was already almost twice what it earned in the whole of 2003 (see chart). Then the signs of trouble began. Nevertheless, despite the recent slowdown in earnings, as *The Economist* went to press analysts were confidently expecting the company to report an annual net profit of around 10 trillion won ($9.5 billion) on January 14th.

That is excellent by any measure. But it is not just with its earnings that Samsung wants to impress. The company is also investing heavily to ensure that history does not repeat itself. Research and development accounted for $2.9 billion in 2003, around 8% of revenue. More than 20,000 of Samsung's 88,000 employees work as researchers in 15 R&D centres around the world. Capital spending is more than $5 billion. The company is building the world's most advanced factory for making giant liquid-crystal displays (LCDs), and between now and 2010 intends to spend around $24 billion on new chipmaking facilities, despite falling chip prices. “Pre-emptive investment is critical to success in the semiconductor industry,” says Lee Kun-hee, Samsung's chairman.



And more money will be spent on brand-building. A decade ago, Samsung was mostly seen as a producer of cheap televisions and microwave ovens. Mr Lee complained that, while Samsung could build a TV that was technically just as good as one made by Sony, his sets would sit at the back of a store or be piled up high in discount chains. He wanted to move upmarket. But Samsung, like many Asian producers, was a business geared to pushing products out of the door as quickly and as cheaply as possible. Switching tactics would involve wrenching changes.

The 1997 financial crisis made the transition possible, says Mr Yun. “Our capital was almost completely eroded,” he adds. By July 1998, the company was losing 170 billion won a month. As employees realised that even a firm as big as Samsung could go bust, a restructuring plan was launched. Its scope (and its success) came as a shock in a country that has some of the world's most militant trade unions: around 30% of employees lost their jobs as the company slimmed down and sold more than 100 non-essential businesses. There was also a desperate need to cut inventories, says Mr Yun. So he closed factories, sometimes for weeks at a time. As more emphasis was placed on designing better, more attractive products, the firm also made a concerted effort to raise its profile in the minds of consumers.

In 1999, Eric Kim was recruited to run a global marketing office. He was born in South Korea, but brought up in America where he had worked for a number of technology companies. At first Mr Kim was treated warily, but he succeeded in unifying fragmented sales channels that used more than 50 different advertising agencies. He also made the most of the company's prowess in

technology, launching consistent and more daring advertising campaigns. Samsung also used product placement to good effect; lots of its futuristic gadgets appeared in the cult movie “Matrix Reloaded”. And the company decided to become a principal sponsor of the Olympic Games. Following the success of the Athens games last year, this has paid off, with another big increase in consumer awareness of its brand. Mr Kim more than doubled Samsung's annual marketing budget to about $3 billion.

In September last year, Mr Kim suddenly decamped to join Intel, Samsung's main chipmaking rival and a company that harbours its own ambitions to expand into consumer products. Gregory Lee, who has worked with a number of American consumer-goods companies, took on the role, inheriting a global review of Samsung's advertising. The complexity of modern consumer marketing has led some big companies to want to deal primarily with just the parent company of one of the handful of global advertising groups rather than trying to manage lots of specialist agencies. WPP, a British-based group, won that central role for Samsung.

Planning is now under way for the next big campaign. According to Interbrand, a consultancy, the value of Samsung's brand is now close to that of Sony. However, the South Korean company is “not yet a brand that can live without the product,” says Jan Lindemann, Interbrand's head of brand valuation. The next step is to encourage customers to turn to the Samsung brand before they think about what product to buy, rather than being led to the brand by an interesting device. To get to that iconic status, Samsung has to be perceived as even more “cool” than it is today.

But there was something else that allowed Samsung to transform itself. There are times in any industry when a step change in technology lets new leaders emerge, believes David Steel, vice-president of Samsung's digital-media business. He says the transition from analogue devices to digital ones provided Samsung with its moment. The convergence of digital products and services may provide another. Suddenly there seem to be more opportunities than ever before to combine different devices. For instance, MP3 players, which can store music downloaded from the internet, are being incorporated into mobile phones. With the addition of a lens and fast memory chips, the phones become usable as digital cameras and camcorders too.

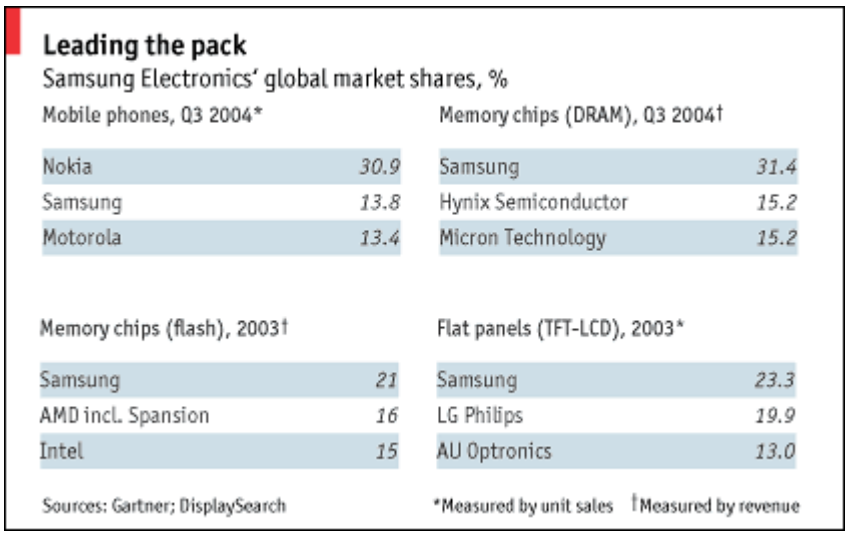
Many people think that the mobile phone will emerge as a central device in the digital future. South Korea, where more than three-quarters of the population have mobiles, provides good evidence for this. Many people already use their handsets for e-mail and even video-messaging—and 20% of them buy a new handset every seven months. A new high-speed wireless service will soon deliver even whizzier services to portable devices, including high-definition television. The fact that South Korea is now one of the most-wired countries in the world has provided Samsung with an advantage: a ready-made laboratory for testing consumer reactions to new digital technologies.

Marvellous mobiles

The mobile phone has certainly done the most to help Samsung's new image. Handsets have become fashion statements, and an aid to selling other things, says Interbrand's Mr Lindemann. But a decade ago it was a different story. South Koreans “didn't see us as a high-quality company,” says Choi Chang-soo, vice-president of Samsung's mobile communications division. To change that perception, Samsung set out to make a handset that could be marketed as one that “works better in Korea”. It was, for instance, more sensitive and so could receive and make calls in places such as basement restaurants that are often shaded from signals. The company also developed its own keypad interface for Korean characters.

It was also a struggle to get Samsung's handsets accepted as premium products by overseas operators, says Mr Choi. But eventually the business took off. Samsung helped to popularise the

“clamshell” design and in 2004 launched the first handset that will work with both the CDMA and GSM systems used in different parts of the world. According to Gartner, a firm of technology analysts, in the third quarter of 2004 Samsung nudged ahead of Motorola by selling almost 23m phones worldwide, giving it a 13.8% market share, the second biggest after Nokia (see table).



Leading the pack

Samsung Electronics' global market shares, %

Mobile phones, Q3 2004*

Nokia	30.9
Samsung	13.8
Motorola	13.4

Memory chips (DRAM), Q3 2004†

Samsung	31.4
Hynix Semiconductor	15.2
Micron Technology	15.2

Memory chips (flash), 2003†

Samsung	21
AMD incl. Spansion	16
Intel	15

Flat panels (TFT-LCD), 2003*

Samsung	23.3
LG Philips	19.9
AU Optronics	13.0

Sources: Gartner; DisplaySearch

*Measured by unit sales †Measured by revenue

With many of its most profitable products now coming under pressure, is Samsung's remarkable resurgence about to come to an end? Michael Hoosik Min, who follows the company for Dongwon Securities in Seoul, believes that although earnings are bound to come under pressure, it will be the next generation of products in Samsung's pipeline that will really determine whether or not the firm can maintain growth or will lose its new-found status as a premier brand.

In the short term, however, the slowdown in the semiconductor market will hurt, not least because 2004 was such a good year. The company's revenue from chips grew by more than 50%, reckons iSuppli, which analyses the market for electronic components. While Intel remains the biggest chipmaker, it specialises in microprocessors, which are at the heart of computers. Samsung leads in memory chips, a distinct category that includes the small flash-memory used in digital products like cameras and mobile phones. The year ahead “will be a real challenge,” says Nam Hyung Kim, iSuppli's chief memory-chip analyst. He expects the market's growth to fall below 5%.

Screen tests

The prices of flat-screen televisions are also coming down as competition grows and capacity increases. A 32-inch LCDTV that would have sold for around $3,800 in America in 2003, now fetches about $2,400. Although lower prices expand the market, they also put pressure on producers to slash manufacturing costs in order to protect profit margins. LCDs are made in the same sort of giant ultra-clean factories used for manufacturing semiconductors. The huge capital investments required mean that some producers are spreading the risks through joint-ventures, such as the one between Europe's Philips and LG, Samsung's main domestic competitor. Last summer, Samsung and Sony decided to join forces too and will share the output from a “seventh-generation” LCD factory being built in South Korea.

It may seem strange for Samsung to do deals with the company so closely identified as its main competitor, but in the consumer electronics industry rivals often buy components and even complete products from one another. In the mid-1990s, more than a third of Samsung's business

came from supplying other companies. Although that proportion has fallen, customers such as Sony, Dell and Nokia are still important, especially for Samsung's memory chips, which are often customised to a company's specific requirements.

Samsung, on the other hand, tends to make most of its own components or buy them from within the group of companies to which it belongs. Samsung Electronics is part of a *chaebol*, one of the giant family-controlled conglomerates that, with government backing, built up South Korea's economy after the war with the north ended in 1953. The Samsung firms, which do everything from running hotels to providing insurance and building apartments, are held together by a complex web of cross-shareholdings. The obvious danger for *chaebol* firms is that favouritism, rather than business acumen, could lead one to buy from another. The links are certainly strong. Even after the review of advertising, Cheil Communications, South Korea's biggest ad agency and a member of the Samsung group, kept the account for Samsung Electronics' home market.

Today most manufacturers have taken a different route, preferring to buy many components and services from outside suppliers, believing this helps them reap better economies of scale as well as offering them the flexibility to pick and choose from among the world's best or cheapest. But Samsung shows no sign of changing direction. On the contrary, its executives argue that being more vertically integrated, supplying its own needs or buying from closely associated group firms, has become enormously useful as digital convergence has blurred product categories. But this approach does, they admit, require checks and balances. Each of Samsung's business units is run as a separate profit centre and has to compete with outside suppliers for orders. If more flattery were needed, Sony—in the midst of restructuring its own electronics division after a big loss—is now also aiming to make more of its components in-house.

Samsung Electronics has helped to make the Samsung business empire the biggest *chaebol* and Mr Lee, son of the founder, one of the most powerful magnates in Asia. He directly owns 1.7% of Samsung Electronics, but is said to control a further 10% through various affiliates. The *chaebol* have been notorious for investing in anything that took their owners' fancy—and for bailing out their mistakes with the profits from their successful businesses. Mr Lee, even in the teeth of the Asian economic crisis, spent $3 billion trying to get into the car business before selling 80% of the venture in 2000 to France's Renault.

AFP

Look, no thumbs needed

Such things still cause unease among investors, which is something Mr Yun is trying to change too. Samsung Electronics maintains its own local stockmarket listing and, unusually for an Asian firm, has been returning money to its shareholders through share buy-backs and dividends. Some 60% of its shareholders are from overseas, which raises some hackles in South Korea. Nevertheless, as the most widely held of emerging-market shares, Samsung Electronics was rewarded with a market capitalisation in 2004 of $62 billion; by that measure it is already worth far more than Sony.

Out of the chaebol

Samsung Electronics could be more valuable still if it could shrug off the so-called “Korea discount” applied by nervous investors. Mr Yun believes that the discount will go when, as he intends, Samsung Electronics seeks a listing on the New York Stock Exchange. The main company can already meet the listing requirements, he says, but there is still some work to be done with subsidiaries.

One thing that seems unlikely to change is Samsung's commitment to making its own hardware. Samsung's executives think it is better to collaborate with content providers (unlike Sony, which also has its music, movie and computer-games businesses). A Sony executive admits that worries about protecting its music business delayed the Japanese company's entry into making MP3 players. After the old Walkman, Sony should have been the natural leader with a networked replacement. Instead the lead was snatched by Apple with its iPod. Samsung does not want to be caught in a similar trap.

The battle for the digital future is far from over. It is not just a revitalised Sony, whose electronics division has now moved back into profit, that Samsung must worry about. There are other powerful Japanese producers, such as Sharp and Matsushita Electric, whose brands include Panasonic, that the South Korean company must watch out for. And closer to home it must keep an eye on LG. Nor will other producers, including Nokia, Intel or Canon, allow parts of their business to be easily stolen away through digital convergence. But all that is the sort of competition Samsung expects. A bigger worry may still be a few years away. Might a relatively unknown electronics manufacturer somewhere in China decide that, if Samsung was able to move from the darkest shadows to the top of the tree, then perhaps it could too?

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Leading economic indicators

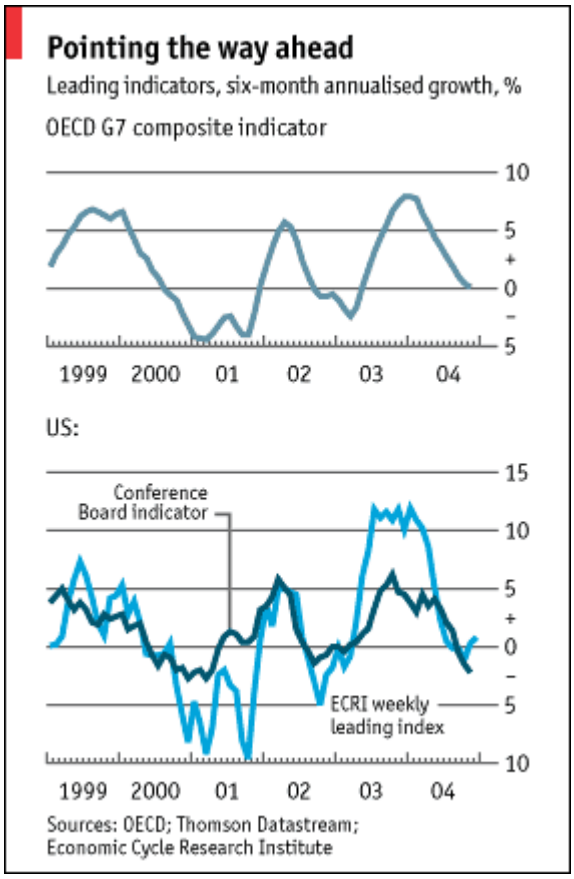
Divining the future

Jan 13th 2005
From The Economist print edition

The case for keeping a close eye on leading economic indicators

IS THIS a good time for your company to expand? Or for you to splash out on that new car? The answer may well depend on the likelihood of a sharp economic downturn in the next year or two. Economic forecasts say the risk is slight: in *The Economist*'s most recent monthly poll, the average prediction of America's GDP growth this year was a robust 3.5%—less than in 2004, but above the long-term trend. However, other guides to the future, known as leading economic indicators, tell a different story. Several of these suggest that the slowdown in many economies in the second half of last year was not just a “soft patch”, but may prove more prolonged.

Take the OECD's composite leading indicator for the G7 economies. Its six-month rate of growth has fallen for ten consecutive months (see chart). Similarly, the growth rate of the most closely watched leading indicator for the American economy, published by the Conference Board, a business-backed group, has plunged in the past year. On past experience, this points to a sharp slowing of GDP growth in the first half of this year.



Should you trust the leading indicators or the forecasts? Embarrassingly, conventional economic forecasts have rarely correctly predicted a recession. In late 1981, when (it later transpired) America's economy was already shrinking, the average forecast for GDP growth in 1982 was over 2%. In the event, output fell by 2%. In August 1990, the very month that America dipped into its next recession, the consensus was that the economy would grow by 2% in 1991; again, output declined. In early 2001, the average forecast for growth that year was also close to 2%. We now know that a recession was already under way.

Some economists argue that recessions are typically caused by unpredictable shocks, such as the events of September 11th 2001 or a sudden rise in oil prices. But that excuse will not do, at least for 2001: official figures show that the recession started months before the September attacks. The trouble is not the unpredictability of events, but that the economic models on which forecasts are based are not up to the job. Despite containing hundreds of equations, models are notoriously bad at predicting recessions because they tend to extrapolate the past, for most of which the economy has been expanding. Yet recessions stem from abrupt changes in the behaviour of firms and consumers.

Scrutinising indicators that have given advance warning of downturns in the past, such as share prices, order books or the shape of the yield curve, seems more helpful than relying on models. There is no single magic measure; each leading indicator has failed to predict a turning point at one time or another. But leading indicators are unlikely all to give false signals at the same time, so a composite index that combines several economic and financial measures stands a good chance of spotting changes in the economic weather.

In a survey in March 2001, 95% of American economists said there would not be a recession. One of the few exceptions was the Economic Cycle Research Institute (ECRI), an independent research firm, which that same month correctly forecast, on the basis of its leading economic indicators,

that a recession was unavoidable. ECRI was set up by the late Geoffrey Moore, an early pioneer of business-cycle research who in the 1960s developed the American government's first leading indicator (which is now published by the Conference Board).

Prophet maximisation

ECRI tracks around a dozen leading indices for different parts of the economy. Some of these have a longer lead time relative to economic activity than others, so the firm publishes both a longer leading index, which signals changes in activity about a year in advance, and a shorter leading index, which looks six months ahead. This is one advantage over the Conference Board's leading economic indicator, which conceals useful information by combining longer- and shorter-term indicators in a single measure.

A second advantage is that ECRI publishes a weekly index and is thus always up to date. Moreover, this weekly index largely comprises indicators that are not revised later, such as share prices, bond yields and commodity prices. In contrast, the OECD's and the Conference Board's current historical time series differ from what was published at the time, because the data from which they are constructed have been revised. As a result, the indicators' predictive power is not as good as the revised series imply.

ECRI is perhaps the only organisation to give advance warning of each of the past three recessions; just as impressive, it has never issued a false alarm. In their book “Beating the Business Cycle”, Lakshman Achuthan and Anirvan Banerji (both of ECRI) claim that the firm's weekly leading index has consistently predicted downturns before the Conference Board's measure. Indeed, in April 2001, after ECRI had called a recession, the Conference Board said: “No recession is on the horizon.” ECRI's indices for other economies have also fared well. For instance, it correctly forecast the Japanese recessions that started in 1997 and 2001.

Over the years the Conference Board has used several rules of thumb to decide whether its leading economic indicator is signalling a recession. On its website is a note suggesting that a 2% annualised fall in its indicator over a six-month period, with more than half of the components worsening, provides a reliable though not perfect warning of recession. The rule suggests trouble: the index has fallen at an annual rate of more than 2% in the past six months. More likely, this is a false alarm.

ECRI has no simple rule for determining when the economy is headed for recession. It compares recent movements in its indices with previous business cycles. In order to signal a genuine turn in the cycle the indices must change direction in a way that is pronounced in size, pervasive across individual components and persistent. For example, the weekly leading index fell sharply in 1987 but no recession was called. This was because the decline was not pervasive, but due almost entirely to that year's stockmarket crash.

So how should one interpret the plunge in the past year in all three series of leading indicators? When America's growth weakened in mid-2004, the economy was widely thought to be in a soft patch that would soon pass. The persistent fall in the leading indicators suggests that growth could remain disappointing in the first half of this year. The more timely and (so far) more reliable ECRI index, however, rose in both November and December, tentatively suggesting that the economic slowdown could end by around the middle of this year. A new recession is certainly nowhere in sight. But keep checking those leading economic indicators over the coming months.

America's pension holes

Red and redder

Jan 13th 2005 | NEW YORK
From The Economist print edition

The sorry condition of American states' and companies' pension schemes

AP

Except sometimes

WOULD-BE reformers of America's rickety pension systems have had plenty to chew on this week. On January 10th—the day before George Bush set out his plan to overhaul Social Security, the federal public pension scheme—Elaine Chao, the labour secretary, unveiled reforms intended to shore up America's wobbly company plans. And in his budget, also on January 10th, California's governor, Arnold Schwarzenegger, proposed ways of holding down that state's fast-rising pension obligations to its employees. Among other things, he wants new staff to be offered defined-contribution plans (in which retirement benefits are not guaranteed, but depend on investment returns) and not, as now, defined-benefit pensions.

According to Ms Chao, corporate defined-benefit pension plans, which cover 34m Americans—one-fifth of workers—are underfunded by $450 billion. The Pension Benefit Guaranty Corporation (PBGC), the quasi-governmental insurer of these schemes, is $23 billion in the red, thanks largely to bankruptcies among steelmakers and airlines. States' employee retirement plans look just as bad. Wilshire Associates, a consultancy, reckons that their liabilities exceeded their assets by $366 billion in 2003, the latest available estimate. That figure excludes local-government schemes, which are also underfunded.

The bursting of the technology bubble did much to push pension plans into deficit. But structural problems are also to blame. Ms Chao's proposals for the private sector address the worst of these. She wants to streamline pension-funding rules, which are extraordinarily convoluted and allow companies to tinker with pension-obligation values and hence with required contributions. The reforms would also tie the premiums paid by companies to the PBGC more closely to risk. And they would require further disclosure about severely underfunded plans.

Reform of public employees' schemes is harder, not least because “there are no rules, nothing to keep governments in line,” says Stephen D'Arcy of the University of Illinois. For companies, there are federal rules (however inadequate) on funding, the valuation of pension promises and so forth; but state and local governments decide for themselves.

Some states, such as Illinois, have underfunded their pensions for years. When the stockmarket was surging in the late 1990s, many public pension systems boosted retirement benefits, only to see share prices crash. The sweetening of California's promises to its employees in 1999 has increased the state's pension costs by $508m a year. Cutting promised benefits is politically difficult; in many states, it is illegal. Mr Schwarzenegger's reform will require a constitutional

amendment.

Disclosure is also poor. Annual reports on funding can take as long as two years to be published, says Mr D'Arcy. Important decisions—for example, on whether benefits should be boosted—are therefore based on stale numbers.

Reforms of public pensions have been hard fought. Michigan is one of the few states that have managed to force some employees to switch from defined-benefit to defined-contribution schemes. Many others, including Ohio and Washington, have settled for hybrid systems, in which defined-contribution plans are optional or additional, but take-up by workers is often low. Some states have tried to cut pension costs by changing the terms for new employees. Others have raised more money—either from employees, by increasing their contributions, or from taxpayers.

Some states, encouraged by low interest rates, have resorted to borrowing more. Illinois raised $10 billion, the most yet from a sale of “pension-obligation bonds”, in 2003. This is risky: should investment returns fall short of the cost of borrowing, states' problems will only worsen. In any case, says Parry Young of Standard & Poor's, a rating agency, Illinois's pension scheme is still less than 60% funded, despite its enormous bond issue. More states may well have to follow Mr Schwarzenegger's route.

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Directors and officers insurance

The price of prominence

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From The Economist print edition

Insuring America's corporate bigwigs may become more expensive

WHEN a company and its directors are sued for mismanagement or worse, who pays for the settlement? Usually, an insurance company. Each year, America's biggest firms spend a few million dollars apiece on premiums to cover their directors and officers in case disgruntled shareholders, employees or regulators take them to court. During the first six months of last year, claims worth more than $1 billion were paid by (or came due from) insurers who write directors and officers (D&O) coverage, according to Willis, an insurance broker.

Although directors are used to being sued, they are not in the habit of opening their own wallets in order to pay. Last week's settlements of investors' class-action suits against former directors of Enron and WorldCom are therefore unusual.

In both cases, insurers of the scandal-shattered companies are expected to fork out the bulk of the money ($36m for WorldCom; $155m for Enron). However, ten former non-executive directors of WorldCom agreed to pay, in addition, a total of $18m from their own savings, although they neither admitted nor denied wrongdoing. This is equivalent to one-fifth of their personal wealth, leaving aside their principal homes and pension money. Ten of Enron's former directors will cough up $13m—a disgorgement of insider-trading gains, say plaintiffs. (The WorldCom settlement was challenged this week by several investment banks, which are also defendants in the suit brought by shareholders. The banks, unlike the directors, have not settled.)

The circumstances at these companies were surely exceptional, or so one would hope. And the directors' contributions (for Enron, anyway) are dwarfed by those of the insurers. Still, the settlements have already sparked hot debate about whether it will now get harder to find qualified recruits for company boards. It may be too soon to judge that; but it is clear that the settlements will embolden America's armada of class-action lawyers to redouble their efforts.

“Institutional investors in the US are more and more interested in seeing officers and directors considered to be malefactors make contributions out of their own pockets,” says Melvyn Weiss, of Milberg Weiss Bershad & Schulman, a leading plaintiffs' law firm. Last year the number of new federal securities fraud class-actions, which can trigger the largest D&O payouts, rose by 17%, to 212, according to Cornerstone Research, a litigation consultancy. Often, such suits are filed after a sharp drop in a company's share price, causing losses to investors. The sums sought in the suits are rising. Mr Weiss says this is “because conduct is more and more egregious, and the amounts of losses have become so huge.”

The rise in the number and size of lawsuits probably means that rates for D&O coverage will firm up. Oddly, they fell by 10% last year, according to Tillinghast, an actuarial firm, after rocketing during the few years after America's corporate scandals first broke. The drop did not reflect a reduction in claims but a surfeit of capacity: start-up insurers in America and Bermuda have

rushed to provide D&O cover. But the future looks grim. Rick Welsh of SVB, a British insurance underwriter, says that plaintiffs are seeking $60 billion-80 billion in class-action suits in America that are yet to be settled.

In Europe, the lawyers are not as fierce. Plenty of firms on the continent—in particular, family firms or companies not listed in America—do not bother with D&O coverage at all. In Britain, rates can sometimes be merely one-fifth of those in America, according to Nick Ward of Hiscox, a specialist insurer. One case to watch involves Equitable Life, a British life assurer that nearly collapsed in 2000. The company is suing 15 former directors, including nine non-executives, for up to £1.8 billion ($3.4 billion). A trial is due to start in April. The former directors are believed to have only £5m in D&O cover. That may not be enough even to pay the lawyers.

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Monetary policy

Banking on Fischer

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A surprise nomination to run Israel's central bank

STANLEY FISCHER, the Zambian-born vice-chairman of Citigroup, a former number two at the International Monetary Fund and one of the world's best-known macroeconomists, thought about emigrating to Israel in the early 1970s, but decided to settle instead in America and to teach at the Massachusetts Institute of Technology. “We didn't look back,” he said in an interview last year. “At least not more than once every two weeks or so.”

On January 9th, Mr Fischer, eyes front, accepted the nomination to be the next governor of the Bank of Israel. Once the cabinet approves him, Mr Fischer must renounce his American citizenship, brush up on his Hebrew and no doubt swallow a severe pay cut. To some, it is a wonder that he wants the job.

Certainly, not everyone in Israel wants him. Avraham Poraz, a former cabinet minister, doubts his Zionist credentials. “[I]f he has not been in the wars, and his heart did not palpitate, and he did not go through our anxieties in terror attacks, he is cut off from the Israeli experience,” he told Israeli radio.

Must a central banker feel what the nation feels? Must his heart beat in time with those of his compatriots? According to one well-known theoretical result in macroeconomics, it is better if central bankers do not share the values of the nation at large: to establish the credibility of their fight against inflation, they must be more hawkish than the public they serve.

Besides, Israel is a nation of immigrants. Fewer than 30% of Israelis over the age of 45 are native-born. One past bank governor, Jacob Frenkel, also had to renounce American citizenship to take the post. It is thought that Mr Frenkel, who was a close colleague of Mr Fischer's at the University of Chicago, pushed hard to have Mr Fischer nominated.

The job has certainly been exciting in the past. Between December 1978 and March 1986, prices in Israel rose by 109,187%. Mr Fischer was one of two economic advisers in an American delegation that helped Israel restore monetary calm. The stabilisation programme was one of the most successful of its kind. Indeed, Mr Fischer has wondered if it was not too successful. The country did not suffer enough from its bout of inflation to fear a repeat. As Mr Fischer put it in 1995, Israel's episode of runaway prices “did not leave enough antibodies to inflation in the system.”

The economy has since been thoroughly purged of the inflation bug. Israel even suffered deflation in 2003 and 2004, according to the IMF. Some think the central bank erred in not cutting interest rates sooner. The insecurity and uncertainty sown by terrorism have deterred investment and diverted resources into defence. A steady hand, not a palpitating heart, will be needed in the years ahead.

Futures trading

Patents and publicity

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A fair proposal, or a fishing expedition?

PROFIT, principle, or self-promotion: these are among possible explanations for the unusual action taken recently by Harris Brumfield and his firm, Trading Technologies (TT), a leading provider of trading software for the futures industry. Mr Brumfield's admirers say that he's gutsy; detractors say he's an egotist: nearly everyone agrees he is trying to turn the industry on its head. Whatever his motives, Mr Brumfield, who was a Mississippi catfish farmer before becoming a futures trader and entrepreneur, has grabbed plenty of attention.

In a plan first floated in December and repeated in full-page advertisements in the financial press this month, TT calls for the world's four largest futures exchanges (where, it claims, 50% of volume flows through its software) to pay a fixed, permanent fee of 2.5 cents for every transaction made using its programs. In return, TT promises permanent access to its products and no lawsuits over patents (it is embroiled in just such a battle with eSpeed, a rival spun off from Cantor Fitzgerald, a bond broker). TT claims it would have made $130m in revenue in the past year had this formula been in place; instead, despite its large market share, it is now “barely profitable”, while the exchanges have been making record gains in volume. Many of its software competitors are in worse financial shape.

The idea was panned when first unveiled. Now, TT contends, some traders and brokers are (privately) warming to it. But many market observers and participants, not to mention the exchanges, remain sceptical. “Do the exchanges want to be held hostage by a player in a dominant position?”, asks John Lothian, who is the editor of a leading futures newsletter. “This isn't good for the futures industry,” says Jodi Burns, an analyst with Celent Communications, who says TT is “trying to get paid twice”, by both software users and exchanges.

The outcome of TT's gamble hinges largely on its suit against eSpeed, now working its way through a federal court. Filed last August, the suit asks the court to bar eSpeed from marketing and operating trading software that allegedly infringes a patent on an electronic ordering screen developed by Mr Brumfield. Industry observers are divided on whether patents on trading software are good for the sector, and just how innovative TT's contested product (called MD Trader) really is. The firm says it has 80 patents pending.

The bigger prize in all this for Mr Brumfield, some suggest, is a possible sale of his company. He denies that is his goal, but does not hesitate when asked about possible buyers: he claims banks and exchanges are interested, and in response to a direct question, says he has talked with Microsoft on a “more limited” basis. In the end, though, the former trader swears he wants to stay in his current role. He claims to be having fun stirring up the industry.

Trading arcades

New skills for an old game

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The declining importance of brawn in futures trading

FOR Scott Okamura, electronic trading seems a godsend. A slight 41-year-old, Mr Okamura says that he never did well in his 18 years as a floor trader at the Chicago Mercantile Exchange (CME). In the trading pits, towering ex-athletes with booming voices had an edge. Now the playing field looks a lot more level.

As the futures industry shifts from open-outcry towards screen trading, big, burly men with sharp elbows are out. Twenty-somethings with cool heads and quick fingers (often trained on video games) are in. So are some flexible veterans like Mr Okamura. Rather than trade sitting alone in an office or at home in their pyjamas, a growing number are choosing to work in electronic trading "arcades" or "prop shops" (trading firms that pay them a salary and a slice of profits) offering computers, real-time news streams and the company of other traders, even if they are competitors.

The early arcades were grim places. Now, as demand for skilled screen traders heats up, some prop shops are splashing out on plush digs to lure and retain talent: fancy technology—up to seven screens per trader—in the trading room; and lounges with plasma televisions, video games, pool tables and food outside it. "We want them to be stimulated" even when they're not trading, says Mary McDonnell, president of Geneva Trading, a prop shop with about 100 traders in Chicago and Dublin.

Former floor traders are learning new tricks too. At the CME's Globex Learning Centre, a simulated trading environment, more than 200 people a week come to hone their on-screen skills—including Mr Okamura, before he joined an arcade this month. They range from current exchange members to members' employees (many floor clerks have been fired) and, increasingly, individuals from arcades and prop shops. The centre offers a "Trader DNA" program to help track individual trading behaviour. "This is a completely different way of trading that has to be learned from scratch," says David Norman, whose firm created Trader DNA. Traders can no longer rely on the roar of the pit to help them follow others' order flow; now the game is about technical analysis, macroeconomics and reading volume on the screen.

The change has been rough for some successful floor traders. "You're going from being a big fish in the pond to a nobody," says Ms McDonnell. "It's ego-crushing," she notes, especially for men. Although Geneva hires mostly young employees—it is known for favouring video gamers—it recently started a new training track for ex-floor traders. The veterans' reactions may be slower, says Ms McDonnell, but the youngsters cannot match their experience. "You get some of these kids looking at key past events in the markets, and realise they were three years old at the time."

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Economics focus

Mind games

Jan 13th 2005
From The Economist print edition

Can studying the human brain revolutionise economics?

ALTHOUGH Plato compared the human soul to a chariot pulled by the two horses of reason and emotion, modern economics has mostly been a one-horse show. It has been obsessed with reason. In decisions from how much to produce to whether to save and invest, humans have been assumed to be coolly rational calculators of their own self-interest. Over the past few years, however, evidence from psychology has persuaded many economists that reason does not always have its way. Now, judging from a series of presentations at the American Economic Association meetings in Philadelphia last weekend, a burgeoning new field dubbed "neuroeconomics" seems poised to provide fresh insights on how the two horses together produce economic behaviour.

The current bout of research is made possible by the arrival of new technologies such as functional magnetic-resonance imaging, which allows second-by-second observation of brain activity. At several American universities, economists and their collaborators in the neurosciences have been placing human subjects in such brain scanners and asking them to perform a variety of economic tasks and games.

For example, the idea that humans compute the "expected value" of future events is central to many economic models. Whether people will invest in shares or buy insurance depends on how they estimate the odds of future events weighted by the gains and losses in each case. Your pension, for example, might have a very low expected value if there is a large probability that bonds and shares will plunge just before you retire.

Brian Knutson, of Stanford University, carried out one recent brain-scan experiment to understand how humans compute such things. Subjects were asked to perform a task, in this case pressing a button during a short interval in which a certain shape was flashed on to a screen. In some trials, the subjects could win up to $5 if successful, while in others they would have to defend against a $5 loss. Before presenting the target, the researchers signalled to subjects which kind of trial they were in.

Brain activity in certain neural systems seemed to reveal a strong correlation with the amount of money at stake. Moreover, the prospects of gains and losses activated different parts of the brain. Traditional economists had long thought—or assumed—that the prospect of a $1,000 gain could compensate you for an equally likely loss of the same size. In subsequent trials, subjects were given another signal: one that provided an estimate of the odds of success. That allowed the researchers to identify the regions of the brain used for recognising an amount of money and for estimating the probability of winning (or losing) it. Having identified these regions, the hope is that future work can measure how the brain performs in situations such as share selection, gambling or deciding to participate in a pension scheme.

David Laibson, an economist at Harvard University, thinks that such experiments underscore the big role that expectations play in a person's well-being. Economists have usually assumed that people's well-being, or “utility”, depends on their level of consumption, but it might be that changes in consumption, especially unexpected downward ones, as in these experiments, can be especially unpleasant.

Mr Laibson's own work tries to solve a different riddle: why people seem to apply vastly different discount rates to immediate and short-term rewards compared with rewards occurring well into the future. People tend much to prefer, say, $100 now to $115 next week, but they are indifferent between $100 a year from now and $115 in a year and a week. In one recent experiment, noted in our science section on October 30th, Mr Laibson and others found that the brain's response to short-term riches (in this case, gift certificates of $15 or $20) occurs largely in the limbic system, a region that governs emotion. By contrast, the prospect of rewards farther into the future triggers the prefrontal cortex, which is often associated with reason and calculation. Thus, choosing immediate economic gratification, by spending excessively on credit cards or not saving enough even though you “know better”, could be a sign that the limbic system is in charge. Government policies, such as forced savings or “cooling off” periods for buying property or cars, may be one remedy.

And then there is trust and deception. Colin Camerer, of the California Institute of Technology, has conducted experiments in which brain-scanned participants play strategic games with anonymous partners. In these, a subject chooses his own actions and also tries to anticipate the choices of the other player. When players are doing the best that they can to “win” the game by anticipating their opponents' moves, their brains tend to show a high degree of co-ordination between the “thinking” and the “feeling” regions. Economic equilibrium, by this measure, is an identifiable “state of mind”.

Don't let it go to your head

Some neuroeconomists claim that such brain-scanning experiments are the start of a revolution in economics. No longer will economists rely on crude statistical models of how people behave in response to a policy change, such as an interest-rate rise or a tax increase. Instead, they will be able to peer directly into the brain to predict behaviour.

One day, perhaps; but much work remains. Identifying the parts of the brain that control economic actions is one thing. Harder tasks include determining how neural systems work together to create behaviour, and how wide is the variation in brain patterns between different people. Then there are age-old questions of free will: is your failure to save for old age simply a lifestyle choice, or is it down to faulty brain circuits? Neuroeconomics is already providing fascinating conclusions. But Plato's chariot will remain an alluring explanation for a while yet.

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Astronomy

In the beginnings

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Young solar systems are like cosmic snooker games, and the universe is flat

CREATIVE destruction is central to economic growth. It is also believed by many researchers to be central to the growth of solar systems. Planets, the theory goes, evolve by colliding with each other. Sometimes such collisions result in the protagonists sticking together and making a bigger planet. Sometimes, by contrast, they knock lumps off one another, as is thought to have happened when the Earth's moon formed. Then, it appears, the proto-Earth was hit by something the size of Mars. When the dust had settled, the result was what is, in effect, a double planet.

Looking back across the 4.5 billion years since that occurred is obviously an exercise fraught with guesswork. But telescopes have now reached the point where they should be able to see evidence of similar collisions in other, younger solar systems. And two of those telescopes, the Gemini Observatory telescope in Chile, and the Spitzer Space Telescope, in orbit around Earth, have recently come up with the goods.

The solar systems in question, both visible in the telescopes as dusty discs, belong to stars called Beta Pictoris and Vega. At 10m-20m years of age, Beta Pictoris is barely out of the womb. In the case of Vega the disc is noticeably more evolved, though at 350m years old, Vega is still an infant compared with the sun.

What Charles Telesco of the University of Florida in Gainesville and his colleagues have observed within Beta Pictoris's disc, as they report in this week's *Nature*, are distinct bright spots at various wavelengths of infra-red light. The researchers interpret these as clumps of dust within the disc, and since the wavelength indicates the temperature of the dust, which depends on its distance

from the star (which is known), its composition and its size, it is possible to say that the dust in the clumps is different in composition, or size, or both, from the dust in the rest of the disc. That suggests the clumps are the results of collisions between small planets. Indeed, a more detailed (though more tentative) analysis of the size of the fragments in one clump suggests that the collision which formed this particular clump happened within the past few decades. That is because the dust produced would quickly be dispersed by the pressure of Beta Pictoris's light.

In the case of Vega, the solar system should have evolved to a point where there is little of any kind of dust kicking around naturally, yet there is a lot. And since it, too, will tend to be driven into deep space by the pressure of the light from the central star, there must be a dust factory in the system somewhere.

As Kate Su of the University of Arizona, Tucson, told a meeting of the American Astronomical Society in San Diego this week, that factory, too, is probably a gaggle of colliding small planets. But there is a twist. Her calculations suggest that the main collision happened about 1m years ago. What is actually generating the dust is continual “sub-collisions” between the fragments that the bigger one created. In the context of these two results, it seems that young solar systems resemble cosmic snooker tables, in which the balls are constantly bumping into each other. Only as they enter middle age do they settle down to consist of well-spaced planets in stable orbits.

How to bake a universe

To human eyes, other solar systems may be incomprehensibly distant, but cosmically, they are pretty close by. Some other results that came out this week, however, are on a rather grander scale. They concern the vexed question of what the universe is made of.

The current theory is that it has three ingredients: “normal” matter, “dark” matter and dark energy. Actually, in their order of importance to the universal recipe, the list should be reversed. Both theory and previous observations suggest there is more dark energy than dark matter, and more dark matter than normal matter. But the exact proportions are important. They bear on the question of how galaxies form and, indeed, on the fate of the universe.

Again, two teams using two telescopes were involved: the 2-degree Field Galaxy Redshift Survey (2dFGRS) has an instrument in Australia and the Sloan Digital Sky Survey has one in New Mexico. Both are designed to look at hundreds of thousands of galaxies, and to pinpoint their location in the sky and their distance from Earth. The latter is done by measuring the so-called redshift of their light. This is a reddening of a galaxy's spectrum caused by the Doppler effect (the effect that causes a police-car siren to drop in pitch as the car drives away). Because the universe is expanding, most galaxies are moving away from the Earth. The farther away they are, the faster they are moving, and the more their light is redshifted.

Both teams were looking at the way the fine structure of the universe has changed over time (though this is a rather specialised definition of fine structure, since it is looking at the distribution of galaxies). The 2dFGRS's aim was to confirm the ratio of normal to dark matter. Since both are affected by gravity they are attracted to each other, so the distribution of normal, visible matter acts as a proxy for the distribution of dark matter. But not a perfect one.

Dark matter has nothing to resist gravity, so it collapses in on itself rapidly. Normal matter, which is mostly gas, has pressure—and that resists gravity. This means that normal matter collapses more slowly than dark matter, and that when it does so it has a tendency to oscillate, generating a sound wave. The distribution of normal matter in the early universe (380,000 years after everything began, which was 13 billion years ago) was worked out a few years ago by looking at the background of microwaves left over from that early epoch. Ripples in this radiation are, in

effect, fossils that reflect patterns of sound in the early universe. That, in turn, depends on how matter was distributed within that early universe. 2dFGRS, by contrast, looked at the distribution of matter over the past 2 billion years.

Comparing the two shows how much gravitational collapse has happened. If all matter were dark, it would have collapsed a lot (and, of course, there would be no humans around to observe what is going on, since people are made of normal matter). If it were all normal, there would be far less collapse, and in all probability no galaxies (so, once again, no humans). In fact, previous observations using different techniques had already shown that normal matter was about a fifth of the total. But the 2dFGRS team was able to pin the figure down precisely. At a meeting in London, they announced it was 18%.

That still leaves dark energy—which is where the Sloan survey comes in. This also looked at the effect of fossil sound. Besides being frozen into the microwave background, the effects of the primordial cacophony should have been frozen into the structure of the universe. That means they will have expanded with it, producing peaks and troughs in the density of the galaxies that formed from primordial matter. As they announced at the meeting in San Diego, the Sloan survey team was able to pick up such a density peak at a distance of 500m light years. Plugging that figure into the theory suggests that 77% of the stuff in the universe is the most mysterious stuff of all—dark energy. Again, that is not a surprise. But it is a precise figure where previous estimates were fuzzier. It also confirms that the proportions of normal matter to dark matter to dark energy are exactly what is needed to make space flat, rather than curved.

And that geometrical prediction was confirmed directly by the Sloan survey, using the known distances of 500m light years to the density peak and 13 billion light years to the region where the microwave background originates as reference points to look for geometrical distortion, in the way that a more traditional land survey might use triangulation points. A flat universe is one that will expand forever, never coming to any definite conclusion.

So there you have it. The universe is flat, infinitely prolonged, and the more common something is in it, the less we know about it. Oh, and as far as making planets is concerned, God may not play dice, but He is a mean hand at snooker.

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Space exploration

Three for one

Jan 13th 2005
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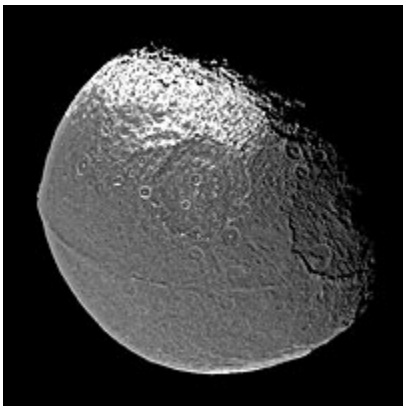
Those space probes in full



Iapetus's ridgeway

THE mysteries of other solar systems, and indeed the whole universe, are one thing (see article). But the past few days have also seen developments in the study of Earth's backyard. It has been a busy week for NASA, America's space agency, and ESA, Europe's.

First, on Monday, its scientists released high-resolution photographs of Iapetus, one of Saturn's moons, that had been taken by *Cassini*, a NASA spacecraft that is orbiting Saturn. Every newly observed body in the solar system seems to have one mysterious feature that provokes the curiosity of scientists. In the case of Iapetus it is a ridge around the moon's equator, clearly visible in the photograph. In places, the ridge is 13km (8 miles) high. It is almost as though the body has been carelessly glued together from two preformed hemispheres.

The second event was the launch on Wednesday of *Deep Impact*, a craft which, thanks to the skills of NASA's orbital-trajectory designers, will arrive at its target, comet Tempel-1, on July 4th. The day beforehand it should have released a copper “impactor” weighing 370kg (820lb) that will punch a crater in Tempel-1's surface. The idea is to create an impressive extraterrestrial firework display to celebrate the success of the American rebellion while at the same time allowing the mother-ship to record what is inside the comet.

The third event had yet to take place when *The Economist* went to press. This was the arrival (if all went well) of *Huygens*, an ESA-designed daughter-probe launched from *Cassini*, on Titan, the largest of Saturn's moons. Titan is interesting, in particular, because it has an atmosphere. That is rare among moons, which usually have too little gravity to retain a gaseous cover. But in Titan's case the atmosphere is not merely of interest in its own right, it is also a veil over the moon's surface. That means that *Huygens*'s controllers have little idea of what their craft will be getting itself into.

The atmosphere itself is rich in methane, a simple hydrocarbon, and the surface seems to be covered with soot made from more complex hydrocarbons. Titan seems to be a hydrocarbon-rich body, and some of its students suspect that small dark patches visible through the atmospheric veil are hydrocarbon lakes.

With all these carbon-rich chemicals around, there is inevitably loose talk about the “L” word. Rest assured, there is unlikely to be life on Titan. The researchers know that. But they also know, in their heart of hearts, that it is the prospect of finding extraterrestrial life that keeps the whole

show on the road.

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Chemistry

Elementary

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Evidence that superatoms exist could unsettle the periodic table

THE periodic table of the elements is a comforting document. Within a few simple lines it manages to tame the seemingly chaotic world of matter into a reliable regularity. Each type of atom has its own pigeonhole, its place in the order of things. And the beauty of the periodic table is that the way it groups atoms allows some prediction of how they should behave. The noble gases such as helium remain aloof and unreactive, while the alkali metals can be expected to be silvery and reactive.

Such certainties are now being questioned by work showing that special clusters of atoms behave in unexpected ways. Research published in this week's *Science*, by Shiv Khanna of Virginia Commonwealth University, Welford Castleman of Pennsylvania State University and their colleagues, has found that some unusual clusters of atoms behave like single atoms of other elements. A cluster of 13 atoms of aluminium, for example, was found to behave as though it is a single atom of the halogen group, which includes chlorine and iodine.

“Superatoms”, as the researchers dub them, are a surprising and fascinating finding for chemists. Monoelemental clusters are already known. One of the most famous is buckminsterfullerene, a soccerball-shaped structure composed of 60 carbon atoms which is sometimes referred to as the buckyball, and which was discovered by Sir Harry Kroto, now a professor of chemistry at Florida State University. However, buckyballs are different from superatoms as they do not pretend to be another element entirely.

The chemists behind the suggestion of superatoms do not yet completely understand how and why these structures form, but the key to their behaviour is that they mimic the way that the electrons of another atom would present themselves to the world. The best candidates for making superatoms, therefore, are elements that are able to form very stable structures in clusters of a certain number of atoms, and that share their electrons easily. At the moment, the team has only positively identified clusters of 13 and 14 aluminium atoms as superatoms.

One of the most important points about superatoms is that they are able to react with other elements and form entirely new chemicals. In one example, the researchers reacted a superatom of aluminium that mimicked members of the alkaline earth group (calcium and magnesium, for example) with iodine. The combined structure had a unique new chemistry, so it seems likely that superatoms might form the basis of new families of chemicals.

It is too early to be sure what the long-term significance of this will be. One possibility is that it is just an intriguing but obscure wrinkle. On the other hand, it may be that a small window has been opened that looks on to an entirely new field: superatom chemistry. And if this is the case, there may be a new kind of periodic table waiting to be discovered. Perhaps the flat and two-dimensional periodic table of the elements, known since 1869, needs another, third dimension.

Things might not be as elementary as they seem.

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Ageing

The stronger sex

Jan 13th 2005
From The Economist print edition

Why do women live longer than men?

WOMEN live longer than men. It is unfair, but true. In developed countries, the average difference is five or six years. In the poor world the gap is smaller, owing to the risks of childbirth. But nowhere is it absent. The question is, why?

That question can be answered at two levels. An evolutionary biologist would tell you that it is because women get evolutionary bonus points from living long enough to help bring up the grandchildren. Men, by contrast, wear themselves out competing for the right to procreate in the first place. That is probably true, but not much help to the medical profession. However, a group of researchers at John Moores University, in Liverpool, England, has just come up with a medically useful answer. It is that while 70-year-old men have the hearts of 70-year-olds, those of their female peers resemble the hearts of 20-year-olds.

David Goldspink, who revels in the title of Professor of Cell and Molecular Sports Science at John Moores, and his colleagues looked at 250 volunteers aged between 18 and 80 over the course of two years. All the volunteers were healthy but physically inactive. The team's principal finding was that the power of the male heart falls by 20-25% between the ages of 18 and 70, while that of the female heart remains undiminished.

Each volunteer's heart function was measured before exercise and at peak exertion on a treadmill. In particular, the researchers measured blood flow and blood pressure. Their subjects were also given an ultrasonic scan to measure the size of the chambers of their hearts, the thickness of the heart's muscular wall, and its filling and emptying actions.

The researchers found that between the ages of 20 and 70, men lose one-third of the contractile muscle cells in the walls of their hearts. Over the same period, women lose hardly any contractile cells. There is a strong link between the number of these cells and the function of the heart. What remains a mystery is why men lose these cells and women do not.

A previous theory of why women outlive men suggested that the female sex hormone, oestrogen, could have a protective effect on the heart. But Dr Goldspink dismisses this idea, saying that there is no discernible drop-off in female heart function after menopause, when oestrogen levels decrease dramatically. However, oestrogen does have a beneficial effect on blood vessels. The study found that blood flow to the muscles and skin of the limbs decreases with age in both sexes. The changes in the structure of the blood vessels occur earlier in men, but women catch up soon after menopause.

It's not all bad news for men, though. In a related study, the team found that the hearts of veteran male athletes were as powerful as those of inactive 20-year-old male undergraduates. But can men really recover lost heart function after a lifetime of inactivity and poor diet? Is it ever too

late to start exercising? “I think the answer is no,” says Dr Goldspink. “The health benefits to be gained from sensible exercise are to be recommended, regardless of age.” So if you are male and getting on, get on with it.

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History on an environmental scale

Of porpoises and plantations

Jan 13th 2005
From The Economist print edition

Alamy

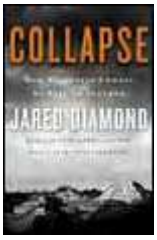
When communities self-destruct

JARED DIAMOND likes his subjects big. His best-known book, “Guns, Germs and Steel”, was in some editions subtitled “A short history of everybody for the last 13,000 years”. This was no conventional history; rather, the author tried to explain the environmental factors behind the rise of various human civilisations. It was a terrific read and full of surprising subplots, such as why some animals can be domesticated and others cannot, and why agriculture spread to some societies but not others.

Now Mr Diamond, a professor of geography at the University of California, attempts to tackle the opposite question, that is, why some societies collapse. Again, he focuses on long-term environmental factors rather than on short-term political ones. Since Mr Diamond is a restless traveller, a ravenous researcher and a sparky writer, the result is gripping.

Among the collapses, he describes the civilisation of Easter Island three centuries ago, whose fall, he argues convincingly, was caused largely by deforestation. Transporting and erecting those extraordinary stone statues required a lot of wood. The early Easter Islanders also used wood to cook their food, cremate their dead and build large canoes. As the population grew, they cut down the big trees.

Collapse: How Societies Choose to Fail or Survive
By Jared Diamond



Viking Books; 575 pages; $29.95. Penguin/Allen Lane; £20
Viking Adult; 400 pages; $29.95. Allen Lane; Â£20

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The ecosystem was wrecked. The soil was rendered infertile, and, with no big logs left with which to build seaworthy craft, the islanders had no means of escape. They could not even paddle far enough out to catch porpoises, which had been a chief source of protein. They ate their land birds to extinction and then they starved. Wars erupted, in which the victors ate the vanquished. A popular insult at the time, apparently, was: “The flesh of your mother sticks between my teeth.”

Amazon.co.uk

The circumstances of a dry, windblown and isolated Pacific island are unusual, yet Mr Diamond finds other examples of poor environmental stewardship that led to calamity, or at least contributed to it. In Rwanda, where the conventional (and certainly correct) account of the genocide of 1994 is that extremist politicians goaded Hutus to kill Tutsis, Mr Diamond notes that mass killing occurred even in an area where there lived only a single Tutsi.

That lone Tutsi was killed, but so too were 5% of the Hutus in this area of 2,000 inhabitants, by other Hutus. Why? Part of the explanation must lie with Rwanda's over-population. Although the country is less densely peopled than, say, Belgium, it has more mouths to be fed by subsistence farming without modern tools.

The homogeneous Hutu area that Mr Diamond describes was especially cramped. All farmland was occupied, and practically everyone was hungry. Uneducated young men could not leave home, set up their own farms, marry and settle down, because space was lacking. Between 1988 and 1993 the proportion of young men living at home with their parents rose from 71% to 100%. That is, not one man in his 20s was self-supporting. To put it mildly, this created tensions. Conflicts between neighbours were common. When the genocide began and normal rules were put on hold, many of these listless young men murdered their richer neighbours, in the hope of seizing their land or cows.

One of the appealing things about this book is that Mr Diamond does not overstate his case for dramatic effect. He does not argue, as some have done, that overpopulation leads inevitably to genocide. He stresses the culpability of the Rwandan politicians who, to crush a Tutsi-led insurrection, imported tens of thousands of machetes and orchestrated the mass murder of Tutsis. He understands that they could have chosen to tackle their problems in a less evil manner. His point is merely that when people are starving because they do not have enough land, it is surely easier to persuade them to kill their neighbours.

Another appealing aspect is that although Mr Diamond is patently alarmed about the state of the world, he believes that things will come right in the end. This “cautious optimism”, as he calls it (though too cautious for this reviewer), is informed by a wide-ranging study of societies that have figured out how to manage their environments sustainably.

His account of how deforestation was reversed in 17th-century Japan, for example, is a heartening case. Because the country was politically stable, the shoguns were able to plan for the long term. They imposed sensible regulations as to who could fell how many trees and how much they should pay for the privilege. They encouraged commercial replanting. And they also enforced something like property rights over farmland and fisheries, thus avoiding a tragedy of the commons.

Errors are probably inevitable in a book of this scope, though some of them jar. It is absurd, for example, to claim that, today, 80% of the world's population live “near or below the starvation level”. The real figure is less than 15%, unless you take a very loose definition of the word “near”. The author's attempt to rebut the idea that greenery costs money is similarly hampered by lousy statistics. Overall, however, the book fulfils its huge ambition, and Mr Diamond is the only man who could have written it.

Collapse: How Societies Choose to Fail or Survive.

By Jared Diamond.
Viking Books; 575 pages; $29.95. Penguin/Allen Lane; £20

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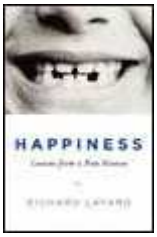
The economics of happiness

Can't buy it?

Jan 13th 2005
From The Economist print edition

FOR the past half-century, those lucky enough to have been born in a rich country have had every prospect of growing richer. On average, incomes in Britain, America and Japan, adjusted for inflation, have easily doubled over that time. On top of this come the benefits of longer lives of better quality, thanks to advances in medicine and to a plethora of consumer goodies making living easier and more enjoyable. You might, even, expect folk to be a great deal happier today than in the 1950s.

Happiness: Lessons from a New Science
By Richard Layard



The Penguin Press; 272 pages; $25.95.

Buy it at
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You would be wrong, according to many surveys taken in rich countries. These tend to show that, once a country has lifted itself out of poverty, further rises in income seem not to create a meaningful rise in the proportion of people who count themselves as happy. Since the 1950s, for example, the proportion of Americans who tell pollsters that they are “very happy” has stayed constant at around 30%, while the proportion who say that they are “not very happy” has barely fallen. Explaining this paradox, and offering suggestions for increasing the supply of happiness, is the aim of a new book by Richard Layard, a professor of economics at the London School of Economics and a Labour peer.

Lord Layard devotes a good portion of the book to a summary of what is known about how to be happy. Much of it will appear self-evident: cultivate friendships, be involved in a community, try for a good marriage. But his big idea is controversial. It is that a zero-sum game of competition for money and status has gripped rich societies, and that this rat race is a big source of unhappiness. Put simply, one person's pay rise is another person's psychic loss. To make that loss worse, says the author, there are only so many top rungs on the ladder of status—and as a peer of the realm, Lord Layard should know.

He is among a growing group of economists who are dissatisfied with the way that the dominant neoclassical school of economics gauges well-being. When they try to divine human desires and happiness, mainstream economists look much more at what people do rather than at what they say. If, perhaps, you choose to work 90-hour weeks and skimp on leisure time, it follows that work is what makes you happy—or at least happier than taking extra time for leisure: otherwise you would not be doing it. Your actions, in other words, are said to reveal your “true” preferences, even if you tell a researcher that you would rather be spending more time with your children (what is known as your “stated” preference).

To counter such Panglossian logic, Lord Layard draws upon the findings of behavioural economists, who make use of the insights and techniques of psychologists. These are more inclined to give credence to people's stated desires and feelings. Among many things, the behaviourists have found that it is relative, not absolute wealth, that matters most to people. Mr Layard cites as evidence a study in which Harvard University students claimed to prefer earning $50,000 a year

when their peers are on only $25,000 to a world in which they earn $100,000 while their peers get more than double that amount. The survey sample is anything but representative, but you get the point.

So, Lord Layard's thinking goes, by spending 90 hours a week in the office, you may be improving your own income, but you are also causing other people to feel less satisfied with theirs. They may be encouraged to work longer themselves just to keep up, taking from the time that gets devoted to family and community.

It is, the author argues, something similar to environmental pollution, where one person's action (or a company's) makes others worse off. Fortunately, he notes, economists have already figured out how to deal with such externalities: tax them so that the polluter internalises the cost of his actions. And so, near the top of Lord Layard's list for improving human happiness, comes the following recommendation: much higher rates of income tax to tame the rat race.

The author singles out income inequality as a psychic wound uniquely worthy of state intervention. But if raising the level of happiness is to be the chief aim of government policy, as he argues it should, where then is the call to make divorce harder, given the pain that he says broken homes inflict on children? Further, where is his desire to compel the worship of a higher being, also on his list as a source of happiness? Thankfully, both are absent, but he never mentions the obvious reason for why they are: namely, that most people value freedom as a greater good than enforced happiness. The pursuit of happiness, Lord Layard's book will convince most people, is a private matter.

Happiness: Lessons from a New Science.
By Richard Layard.
The Penguin Press; 272 pages; $25.95.
To be published in Britain by Penguin/Allen Lane in March

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Marilynne Robinson

An Iowan Troy

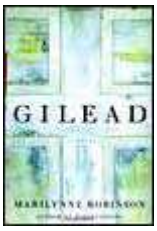
Jan 13th 2005
From The Economist print edition

THIS is only the second book of fiction by Marilynne Robinson in 23 years. Her first, “Housekeeping”, was praised by many. “Gilead” is a surprisingly quiet, modest work after such a wait, and all the more pleasing for it.

The Reverend John Ames is from a line of ministers—his grandfather, an abolitionist, was one of the founders of Gilead, the Iowa town where the pastor still lives. A heart condition numbers his days. The novel is his diary to be left to his beloved seven-year-old son as an apology for a gentle life—though what to the exacting pastor counts for beams in his own eyes look awfully like motes.

Ames is reflective, generously disposed towards others, humble and staunch in the face of religious scepticism. The widower has been remarried for ten years to a poorly educated woman half his age who appeared one day in his congregation. The story of their courtship is a touching one.

Gilead
By Marilynne Robinson



Farrar, Straus and Giroux; 247 pages; $23.

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While much of the book relates local and family lore, the slender plot set in the 1950s focuses on Ames's namesake and feared nemesis, John Ames Boughton, or Jack. Jack is the son of another minister in town and Ames's best friend, but from boyhood a prankster and ne'er-do-well. Now 40, Jack is back in Gilead from a life away and idly plays devil's advocate in theological parries with Ames. Fighting an uncharacteristic dislike, Ames becomes convinced that Jack is waiting for him to die, that Jack might scoop up the elderly minister's lovely young wife and child for himself.

Above all, “Gilead” is about faith, one free of sweetness or sanctimony. The voice is warm rather than sentimental: “These people who can see right through you never quite do you justice, because they never give you credit for the effort you're making to be better than you actually are, which is difficult and well meant and deserving of some little notice.” Ames expresses a great tenderness for this earthly life. Of heaven, he writes: “I can't believe that we will forget our fantastic condition of mortality and impermanence, the great bright dream of procreating and perishing that meant the whole world to us. In eternity this world will be Troy, I believe, and all that passed here will be the epic of the universe, the ballad they sing in the streets. Because I don't imagine any reality putting this one in the shade entirely, and I think piety forbids me to try.”

Gilead.
By Marilynne Robinson.
Farrar, Straus and Giroux; 247 pages; $23.
To be published in Britain by Virago in April

Musicals in London

Spoonfuls of sugar

Jan 13th 2005
From The Economist print edition

There's singing in the rain

Disney

Mary puts them in touch with their inner child

AFTER years of drought, a deluge. A recent flood of musicals pouring into London shows no signs of abating.

Last autumn, theatre talk seemed only about what were quickly called “the big three”: the planned productions of “The Woman in White”, “The Producers” and “Mary Poppins”. These ventures have now all opened and look like running for seasons to come, putting the musical firmly back in the West End.

Before long, these shows will be joined by others. In February comes the premiere of “Acorn Antiques”, a musical version of popular television sketches by Victoria Wood, a British national treasure. (That show has already caused controversy for being the first in the West End to charge a top-ticket price of £65, which at current exchange rates easily outstrips the forbidding $100 for most Broadway musicals.) The spring brings “Billy Elliot, The Musical”, based on the British surprise film success by Stephen Daldry about a young dancing dynamo. A new production will also open of “Guys and Dolls”, the Frank Loesser musical from 1950 that figures on plenty of people's list of the best two or three Broadway musicals. Also in the works—though the mind boggles—is a stage musical of “The Lord of the Rings”.

But what of quality? Of the big shows that have opened so far, “The Producers” remains the musical of choice, even if the backstage drama at the Theatre Royal in Drury Lane rivals what the audience sees. First, Nathan Lane, playing the larger-than-life impresario, Max Bialystock, in the first Broadway production, was drafted in to London at the last minute as a replacement for

Richard Dreyfuss, an Oscar winner who bailed out before the previews claiming he could not cut it. Then Mr Lane suddenly left the show several weeks early. On January 10th the show launched its fourth leading man in as many months—Brad Oscar, a Broadway import.

On stage, “The Producers” certainly provides the laughs you might expect from a show based on Mel Brooks's slice of cinematic anarchy from 1968. And as the unchanging half of the two leads, Lee Evans, a Londoner, brings a sweet-faced innocence to a show about that nastiest of species—the avaricious Broadway mogul who will stoop to any low (“Springtime For Hitler”, anyone?) to ensure a flop. The point, of course, is that Bialystock's hoped-for dud becomes a smash hit, against all odds.

By contrast, too many musicals aim high only to crash. It is difficult to know, for instance, what the creators of “The Woman in White” at the Palace Theatre were thinking when they decided to accompany Sir Andrew Lloyd Webber's latest score with a scenic design that goes so overboard in its computer-generated projections that audience members often claim dizziness and leave. (Either that, or they are suffering from one refrain too many of the composer's anthemic music.)

“Mary Poppins” is far more agreeable to look at—indeed, the colour palette of the designer, Bob Crowley, is an elegant array of mainly blues and greys. Still, the stage version at the Prince Edward Theatre of the 1964 Disney film is both half an hour too long and too larded with homilies, in the unforgiving Disney manner. “Anything can happen if you let it,” you are told in one musical refrain, an assertion that carries with it rather more chilling implications than the tale of an airborne nanny can readily bear.

Those wanting a bit more grit should turn instead to the tiny Donmar Warehouse in London's Covent Garden and its revival of “Grand Hotel, The Musical”, a Broadway entry from 15 years ago that has re-emerged in a scaled-down and commandingly grim production by Michael Grandage. Set in Berlin in 1928, the hotel of the title is a miniature for a society heading towards collapse. The material does not always avoid cliché, and not every song soars. Yet when the performers advance on the audience, scars etched firmly on their faces, you feel an undeniable frisson: dissolution can also be dazzling.

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Russia

Bleak house

Jan 13th 2005
From The Economist print edition

WESTERN views of Russian leaders have turned in a predictable cycle for decades. First there is hope: a new man in the Kremlin may be easier to deal with and make his country a better neighbour. Then there is disillusion: the original expectations are not met, and the wrong things are changing. Then comes fear: either the man himself is turning nasty, or he proves to be ineffective. In each case, the dark forces stop lurking and start looming. Then the new man comes, and hope springs again.

With Vladimir Putin, the cycle has reached its third point. The cheerleaders for Russia who had hoped that the president augured a new era of law-abiding prosperity have largely gone quiet. The “forget Russia” notion, that the world's largest country by size, with the worst-supervised nuclear arsenal, could be left to stew, has few takers. The question that remains is whether the misdeeds of the Russian state, at home and abroad, are because of Mr Putin or despite him.

Three books by journalists cast a gloomy light on the question. “Inside Putin's Russia”, by Andrew Jack, latterly the *Financial Times* correspondent there, is a fluent, detailed and balanced account of Russian power politics, with a lively emphasis on the Kremlin's onslaught against independent media and stroppy tycoons.

Mr Jack also addresses the most sensational charge made against Mr Putin—that the tower-block bombings which killed hundreds of people in 1999 were committed not by the ostensible culprits, Chechen terrorists, but by security services wanting to smooth Mr Putin's rise to power. The charge is not completely absurd, and was well outlined in “Darkness at Dawn” (2003), by David Satter, who set up the *Financial Times*'s bureau in Moscow in 1976.

Mr Jack agrees that the official version of events is full of holes. In particular, the Russian security services have never explained an episode in which they were caught apparently planting explosives in a block of flats in the provincial city of Ryazan. But he steers clear of an all-embracing conspiracy theory—too risky for its backers, he reckons. Instead, he suggests that the Ryazan affair may have been an attempt by spooks to stage a terrorist attack in order to gain credit for foiling it.

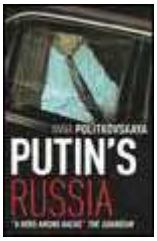
If Mr Jack's book has a weakness, it is that it spends too much time on machinations at the top and gives too little flavour of real life in Russia.

Inside Putin's Russia: Can There Be Reform Without Democracy?
By Andrew Jack

Oxford University Press; 362 pages; $30.
Granta; £20

Buy it at
Amazon.com
Amazon.co.uk

Putin's Russia
By Anna Politkovskaya



Harvill; 291 pages; £8.99

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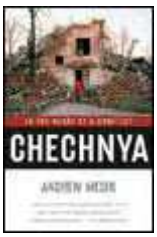
Chechnya: To the Heart of a Conflict
By Andrew Meier

One remedy for that is “Putin's Russia”, by Anna Politkovskaya. The undisputed doyenne of what remains of the free press in Russia, she chronicles the extremes of violence, despair and greed that she witnesses in her travels. The desperate dutifulness of an impoverished nuclear submarine officer makes gripping reading, as does her depiction of the evils visited on Chechens both in Russia proper and their homeland, now a hellhole of cruelty and misery.



Norton; 130 pages; $11.95

Buy it at
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Andrew Meier, *Time* magazine's former Moscow correspondent, covers some similar ground in his slim volume about Chechnya. But whereas Ms Politkovskaya is brave and modest, Mr Meier rather too keenly shows off his erudition and nerve.

Russia is indeed a dreadful place where awful things happen. But books full of dreadfulness leave the reader more dazed than informed. It would be amazing, after decades of totalitarianism and centuries of autocracy, if Russia were not a corrupt, authoritarian and brutal place. The big question is whether it is improving and, in particular, what four more years of Mr Putin will bring.

Here writers flounder. Mr Satter writes eloquently about Russia's moral vacuum, but has less to say about how it might be filled. Ms Politkovskaya struggles to explain why she hates Mr Putin so much: he reminds her of the KGB and the Soviet Union, she says, and his untrammelled power presages a descent into fascism and war. Mr Meier hints, rightly, that Russia's behaviour in Chechnya is a symptom of the country's deeper problems, not a cause, but he goes no further. Mr Jack thinks that Mr Putin's greatest weakness is his soft spot for Russia's Soviet past.

All of that is true. But it is a measure of how little any outsider, local or foreign, understands what is going on inside the modern Kremlin that answering clearly the simple question of how much Mr Putin matters defeats such able writers.

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Obituary

Will Eisner

Jan 13th 2005
From The Economist print edition

Will Eisner, inventor of the modern graphic novel, died on January 3rd, aged 87

Will Eisner, courtesy of DC Comics

ONE weekend in the early 1970s, Will Eisner was invited to speak at a comics convention in New York. Mr Eisner was then a man in a suit: the chief executive of the American Visual Corporation, based in Connecticut, which published pictorial instruction books for companies and government agencies. In a smoky corner of a crowded room at the convention, he was introduced to some long-haired young men from San Francisco.

The young men, talking ardently about politics, ideas and literature, turned out to be comic-strip artists with a strong counter-cultural bent. They knew Mr Eisner as the writer and illustrator of “The Spirit”, a comic strip that, during its heyday in the 1940s, reached 5m readers daily. “The Spirit”, a natty detective in a blue mask who saved Central City from criminals, had not been quite like other comic heroes. He was a superhero, but had no superpowers; he lacked gadgetry and ingenuity; he was an amateur; and the stories seemed focused, sometimes bleakly, on the dark lives of the villains he was chasing.

After that New York conversation, Mr Eisner had an epiphany; he sold the equity in his publishing company and returned to drawing comic strips. This time, however, he would not be working for a syndicate or for a newspaper audience. He intended to earn for comics the serious reputation he felt they had never been granted by the wider world of art.

Mr Eisner objected fiercely to the predictability of most comic strips—created by publishers for, as he put it, “15-year-old cretins from Kansas”. He wanted to modulate the action, let the plots wander, abjure the standard panel-format, and “talk about heartbreak”: in other words, to write and draw for adults. He called his new work a “graphic novel”, and insisted on publishing it with a trade house rather than a comic-strip specialist.

The final product, “A Contract with God”, published in 1978, was closer to the writings of Bernard Malamud or Isaac Bashevis Singer than to any comic art that had preceded it. It consisted of four stories about the residents of a tenement house at 55 Dropsie Avenue in the Bronx (Mr Eisner, the son of Jewish immigrants, grew up in the 1930s in just such a tenement, with dark bare stairways and interlacing washing lines). Instead of heroes, it featured downtrodden, struggling New York Jews, “passengers in transit on a voyage of upward mobility”.

The characters and cityscape were often seen through a moody screen of falling rain—an effect the author used so much that it became known as “Eisner spritz”. The title story, of a man who tried to hold God to a contract, had echoes of both the Book of Job and, more distinctly, of the parables of the Talmud and Midrash. Few characters in the stories were admirable, none was clean-cut, but most evoked a twinge of sympathy. When an interviewer referred to his characters as “losers”, Mr Eisner objected: “They are not all ‘losers’. They are like all of us: unable to prevail against our arch-enemy—Life!”

This wry and melancholy attitude persisted through 21 more graphic novels (Mr Eisner's phrase caught on) and coloured those of many of his successors, too. Indeed, if francophone *bandes dessinées* usually tell vaguely colonialist stories of derring-do, and Japanese *manga* tend to focus somewhat creepily on sexualised children and surreal adventures, Americans, who are not generally known for their melancholy, use their graphic novels to tell sad stories. In 1992 Art Spiegelman (one of the long-hairs who talked Mr Eisner back to drawing) won a Pulitzer prize for his two-volume graphic novel, “Maus”, the story of his father's survival in Auschwitz.

The mark of Cain

Mr Eisner's first teenage comic strips were what most teenagers might produce: a buccaneer saga called “Hawks of the Seas”, and the six-inch-high “Doll Man”. This sort of pulp was churned out in various studio partnerships, including collaborations with Jack Kirby, who later devised “X-Men”, and Bob Kane, who would create “Batman”. Mr Eisner's career did not take off until “The Spirit”, and even that was interrupted for three years during the second world war, while warrant officer Eisner drew a character called “Joe Dope” to instruct soldiers in the use of their equipment. After that came his corporate career, until the conversation in New York.

Towards the end of his life Mr Eisner tackled anti-Semitism, a subject which had dogged him from his boyhood. He wrote a sympathetic biography of Fagin, and his last graphic novel, “The Plot” (to be published in May), was about the forging of “The Protocols of the Elders of Zion”. Mr Eisner saw that anti-Semitism was returning in the 21st century, and believed that comics were strong enough to be ammunition against it.

It constantly bothered him that art critics would not put him in the same category as “real” artists, such as Jackson Pollock or Willem de Kooning. Cartoonists, he complained, “have lived with the stigma, or the mark of Cain”, because their medium was regarded as inferior. “You are now seeing the beginning of a great maturity in this material,” he told a journalist in 2002. “And it will achieve acceptance.” His words implied, however, that there was still some way to go.

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Overview

Jan 13th 2005
From The Economist print edition

The falling dollar has so far failed to reduce **America's trade gap**. Its deficit on goods and services widened to a record $60.3 billion in November as oil imports surged and exports fell. The deficit on goods alone rose to $654 billion in the 12 months to November, up from $547 billion a year ago. The dollar slipped back on the news and yields on Treasury bonds edged up.

By contrast, **Germany's** merchandise trade surplus rose to a record $193 billion in the year to November; its current-account surplus widened to $96 billion.

Non-farm payrolls rose by 157,000 in **America** in December, rather less than expected. The unemployment rate held steady at 5.4% of the labour force.

The average jobless rate in the **euro area** remained unchanged in November, at 8.9%. Consumers continue to sit on their wallets: retail sales rose by a meagre 0.4% in the year to November—well below the gains of 4.3% and 6.1% respectively in America and Britain over the same period.

Canada's jobless rate fell to 7% in December, down from 7.3% in November and its lowest since May 2001.

Industrial production in **Spain** increased by 4.0% and in France by 2.1% over the 12 months to November. That same month, Germany's output fell by 1.7%, leaving it 0.2% lower than a year ago.

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Output, demand and jobs

Jan 13th 2005
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate		
	latest	qtr*	2004	2005	latest		latest		latest		year ago
Australia	+ 3.0	Q3 + 1.2	+ 3.6	+ 3.0	+ 4.6	Q2	+ 5.7	Q3	5.1	Dec	5.8
Austria	+ 2.7	Q3 + 3.2	+ 1.7	+ 2.1	+ 7.4	Oct	+ 2.2	Sep	4.5	Dec	4.6
Belgium	+ 2.9	Q3 + 3.2	+ 2.5	+ 2.1	+ 3.0	Nov	– 0.8	Oct	12.8	Dec†	12.7
Britain	+ 3.1	Q3 + 1.8	+ 3.2	+ 2.4	– 0.9	Nov	+ 6.1	Nov	4.7	Oct††	5.0
Canada	+ 3.3	Q3 + 3.2	+ 2.8	+ 3.1	+ 3.6	Oct	+ 5.0	Oct	7.0	Dec	7.4
Denmark	+ 1.8	Q3 + 0.5	+ 2.1	+ 2.0	– 3.3	Oct	+ 8.5	Nov	6.2	Nov	6.6
France	+ 1.9	Q3 – 0.1	+ 2.1	+ 1.8	+ 2.1	Nov	+ 2.3	Oct	9.9	Nov	9.9
Germany	+ 1.3	Q3 + 0.4	+ 1.3	+ 1.2	– 0.2	Nov	+ 0.1	Nov	10.8	Dec§	10.5
Italy	+ 1.3	Q3 + 1.7	+ 1.2	+ 1.5	– 0.5	Oct	– 3.5	Oct	7.7	Jun	8.6
Japan	+ 2.6	Q3 + 0.2	+ 3.2	+ 1.6	+ 4.3	Nov	– 2.2	Oct	4.5	Nov	5.1
Netherlands	+ 1.5	Q3 + 1.3	+ 1.2	+ 1.2	– 0.7	Nov	– 0.7	Sep‡	6.4	Nov**	5.6
Spain	+ 2.6	Q3 + 2.4	+ 2.6	+ 2.4	+ 4.0	Nov	+ 0.2	Oct	10.5	Nov	11.2
Sweden	+ 3.9	Q3 + 3.8	+ 3.4	+ 2.8	+ 1.2	Nov	+ 7.9	Nov	5.6	Dec†	5.1
Switzerland	+ 1.8	Q3 + 1.4	+ 1.8	+ 1.8	+ 3.5	Q3	+ 3.9	Nov	4.0	Dec†	4.1
United States	+ 4.0	Q3 + 4.0	+ 4.4	+ 3.5	+ 3.8	Nov	+ 4.3	Nov	5.4	Dec	5.7
Euro area	+ 1.8	Q3 + 1.2	+ 1.8	+ 1.6	+ 1.0	Oct	+ 0.4	Nov	8.9	Nov	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 3.2	Q3 + 4.3	na	na	+ 3.1	Nov	+ 2.8	Oct	8.1	Nov†	8.2
Greece	+ 3.8	Q3 na	na	na	+ 2.8	Nov	+ 6.3	Oct	na		na
Iceland	+ 7.4	Q3 na	na	na	na		na		2.7	Oct†	2.8
Ireland	+ 5.8	Q3 na	na	na	–10.4	Nov	+ 1.2	Oct	4.2	Dec	4.4
Luxembourg	+ 2.12003	na	na	na	+ 5.2	Sep	+ 2.8	Sep	4.3	Oct	4.0
New Zealand	+ 4.0	Q3 + 1.9	na	na	+ 5.5	Q2	+ 7.4	Q3	3.8	Q3	4.4
Norway	+ 1.6	Q3 – 3.9	na	na	+ 0.9	Nov	+ 3.3	Nov	3.5	Nov‡	3.7
Portugal	+ 0.8	Q3 – 4.9	na	na	– 3.8	Nov	+ 4.4	Oct	6.8	Q3†	6.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Aug-Oct; claimant count rate 2.7% in Nov. §EU harmonised rate 10.0% in Dec. **Sep-Nov.

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Prices and wages

Jan 13th 2005
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.3	Q3	+ 2.6	+ 2.3	+ 2.5	+ 6.1	Q3	– 0.1	+ 3.7	Q3	+ 5.1
Austria	+ 2.6	Nov	+ 1.3	+ 2.0	+ 1.7	+ 5.2	Dec	+ 2.5	+ 2.0	Nov	+ 2.3
Belgium	+ 2.3	Dec	+ 1.7	+ 2.1	+ 1.7	+ 5.6	Nov	– 0.3	+ 2.4	Oct	+ 1.8
Britain	+ 1.5	Nov*	+ 1.3	+ 1.5	+ 1.7	+ 2.9	Dec	+ 1.8	+ 4.1	Oct†	+ 3.6
Canada	+ 2.4	Nov	+ 1.6	+ 1.9	+ 2.1	+ 4.1	Nov	– 4.1	+ 2.6	Sep	+ 3.0
Denmark	+ 1.2	Dec	+ 1.4	+ 1.2	+ 1.6	+ 3.2	Nov	+ 0.6	+ 2.9	Q3	+ 3.7
France	+ 2.0	Dec	+ 2.2	+ 2.2	+ 1.6	+ 3.1	Nov	+ 0.8	+ 2.7	Q3	+ 2.9
Germany	+ 2.1	Dec	+ 1.1	+ 1.8	+ 1.3	+ 3.8	Dec	+ 1.2	+ 2.2	Oct	+ 1.9
Italy	+ 2.0	Dec	+ 2.5	+ 2.3	+ 2.0	+ 4.2	Nov	+ 1.2	+ 2.7	Nov	+ 2.5
Japan	+ 0.8	Nov	– 0.5	– 0.1	nil	+ 2.0	Nov	– 0.5	+ 1.4	Nov	+ 0.1
Netherlands	+ 1.2	Dec	+ 1.7	+ 1.3	+ 1.2	+ 5.6	Nov	+ 1.1	+ 0.9	Dec	+ 2.4
Spain	+ 3.5	Nov	+ 2.8	+ 3.0	+ 2.8	+ 5.2	Nov	+ 1.3	+ 2.2	Q3	+ 3.1
Sweden	+ 0.4	Dec	+ 1.4	+ 0.7	+ 1.5	+ 2.9	Nov	– 1.6	+ 3.7	Oct	+ 3.2
Switzerland	+ 1.3	Dec	+ 0.6	+ 0.8	+ 1.2	+ 1.9	Nov	– 0.2	+ 1.4	2003	+ 1.8
United States	+ 3.5	Nov	+ 1.8	+ 2.7	+ 2.4	+ 5.1	Nov	+ 3.4	+ 2.7	Dec	+ 1.8
Euro area	+ 2.3	Dec	+ 2.0	+ 2.1	+ 1.8	+ 3.6	Nov	+ 1.4	+ 2.0	Q3	+ 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.5	Nov	+ 0.5	na	na	+ 1.8	Nov	– 0.2	+ 3.1	Q3	+ 4.3
Greece	+ 3.1	Dec	+ 3.1	na	na	+ 2.6	Nov	+ 2.6	na		na
Iceland	+ 3.9	Dec	+ 2.7	na	na	+ 5.9	Dec	+ 3.5	+ 5.4	Nov	+ 5.5
Ireland	+ 2.9	Nov	+ 2.2	na	na	– 1.6	Nov	– 8.4	+ 4.5	Q3	+ 4.6
Luxembourg	+ 2.2	Dec	+ 2.1	na	na	+14.6	Oct	+ 1.0	– 0.1	Sep	na
New Zealand	+ 2.5	Q3	+ 1.5	na	na	+ 2.5	Q3	+ 0.1	+ 2.2	Q3	+ 2.3
Norway	+ 1.1	Dec	+ 0.6	na	na	+ 9.7	Dec	+ 0.7	+ 4.6	Q3	+ 4.2
Portugal	+ 2.5	Nov	+ 2.5	na	na	+ 5.1	Nov	– 0.3	+ 1.4	Sep	– 1.8

*New series. RPI inflation rate 3.4% in Nov. †Aug-Oct.

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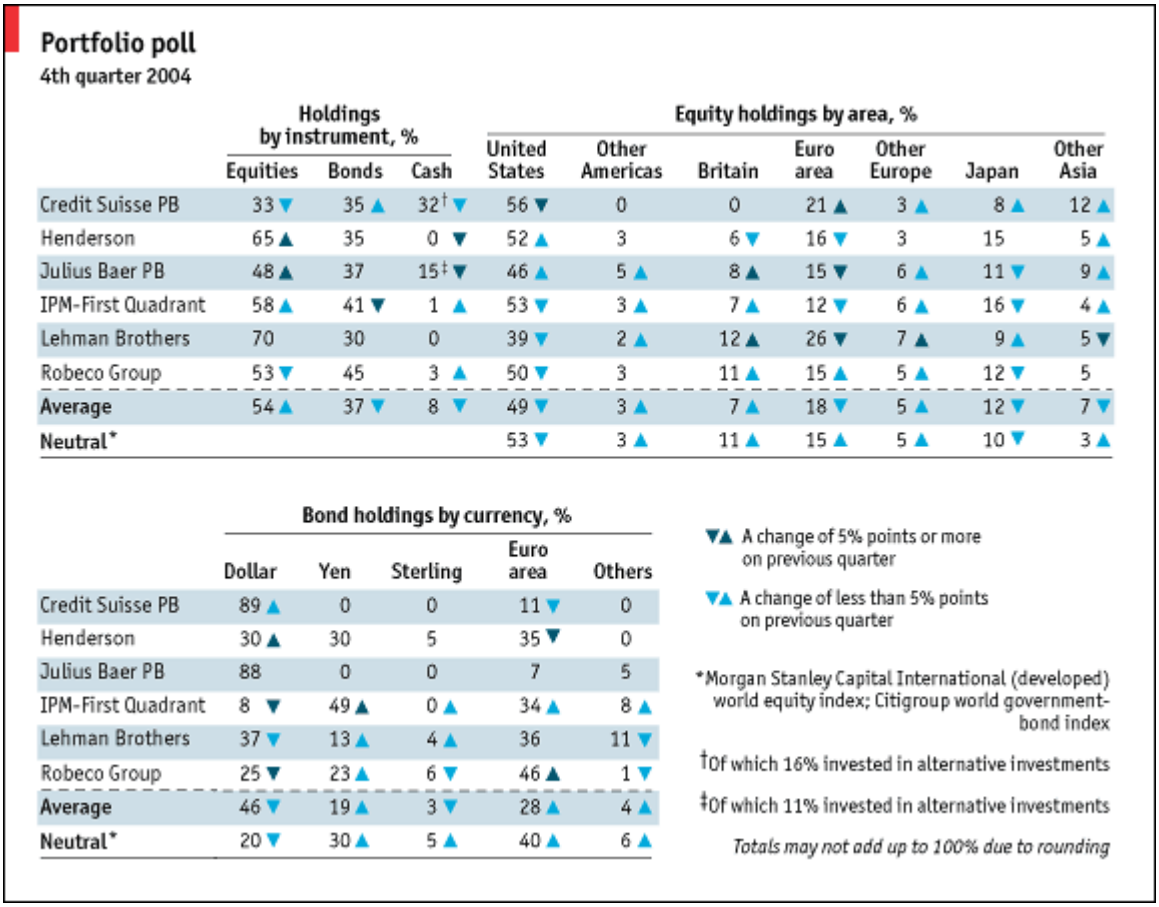
Portfolio poll

Jan 13th 2005
From The Economist print edition



Portfolio poll
4th quarter 2004

	Holdings by instrument, %			Equity holdings by area, %						
	Equities	Bonds	Cash	United States	Other Americas	Britain	Euro area	Other Europe	Japan	Other Asia
Credit Suisse PB	33 ▼	35 ▲	32† ▼	56 ▼	0	0	21 ▲	3 ▲	8 ▲	12 ▲
Henderson	65 ▲	35	0 ▼	52 ▲	3	6 ▼	16 ▼	3	15	5 ▲
Julius Baer PB	48 ▲	37	15‡ ▼	46 ▲	5 ▲	8 ▲	15 ▼	6 ▲	11 ▼	9 ▲
IPM-First Quadrant	58 ▲	41 ▼	1 ▲	53 ▼	3 ▲	7 ▲	12 ▼	6 ▲	16 ▼	4 ▲
Lehman Brothers	70	30	0	39 ▼	2 ▲	12 ▲	26 ▼	7 ▲	9 ▲	5 ▼
Robeco Group	53 ▼	45	3 ▲	50 ▼	3	11 ▲	15 ▲	5 ▲	12 ▼	5
Average	54 ▲	37 ▼	8 ▼	49 ▼	3 ▲	7 ▲	18 ▼	5 ▲	12 ▼	7 ▼
Neutral*				53 ▼	3 ▲	11 ▲	15 ▲	5 ▲	10 ▼	3 ▲

	Bond holdings by currency, %				
	Dollar	Yen	Sterling	Euro area	Others
Credit Suisse PB	89 ▲	0	0	11 ▼	0
Henderson	30 ▲	30	5	35 ▼	0
Julius Baer PB	88	0	0	7	5
IPM-First Quadrant	8 ▼	49 ▲	0 ▲	34 ▲	8 ▲
Lehman Brothers	37 ▼	13 ▲	4 ▲	36	11 ▼
Robeco Group	25 ▼	23 ▲	6 ▼	46 ▲	1 ▼
Average	46 ▼	19 ▲	3 ▼	28 ▲	4 ▲
Neutral*	20 ▼	30 ▲	5 ▲	40 ▲	6 ▲

▼▲ A change of 5% points or more on previous quarter

▼▲ A change of less than 5% points on previous quarter

*Morgan Stanley Capital International (developed) world equity index; Citigroup world government-bond index

†Of which 16% invested in alternative investments

‡Of which 11% invested in alternative investments

Totals may not add up to 100% due to rounding

The money managers in our quarterly poll found little to agree on during the fourth quarter of last year. Only two changed their overall exposure to bonds, and these went in opposite directions: Credit Suisse boosted its allocation, but IPM-First Quadrant cut back. Henderson and Julius Baer increased the proportion of their portfolios devoted to global equities by more than five percentage points while reducing their allocations to cash. The rise of the euro against the dollar did not result in the dumping of dollar-denominated assets across the board. Credit Suisse and Robeco Group adjusted their equity holdings to cut exposure to American markets and boost their euro-area allocation, but Henderson and Julius Baer did the exact opposite. In bonds, our fund managers on average lowered their exposure to dollar- denominated bonds and increased their euro-area investments.

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Money and interest rates

Jan 13th 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Jan 12th 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 3.3	+ 9.9	Nov	5.41	5.49	5.00	5.26	5.55	6.14
Britain	+ 5.2	+ 8.5	Nov	4.81	3.97	4.39	4.51	4.65	5.24
Canada	+12.1	+ 9.9	Nov	2.49	2.45	3.02	4.39	4.55	5.76
Denmark	+12.0	+12.5	Nov	2.25	2.30	2.48	3.71	4.27	5.04
Japan	+ 4.1	+ 2.0	Dec	0.02	0.02	0.09	1.36	1.30	1.46
Sweden	+ 2.2	+ 4.9	Nov	2.00	2.60	2.23	3.70	4.56	2.27
Switzerland	– 5.4	+ 1.4	Nov	0.74	0.24	0.86	2.19	2.57	2.28
United States	+ 6.2	+ 5.4	Nov	2.58	1.04	3.21	4.23	3.98	5.54
Euro area†	+ 9.7	+ 6.0	Nov	2.15	2.09	2.44	3.56	4.11	3.80

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.77%, Japan No. 266 1.36%. Central bank rates: US fed funds 2.25%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jan 13th 2005
From The Economist print edition

1995=100

	Jan 4th	Jan 11th*	% change on one month	% change on one year
Dollar index				
All items	89.2	89.8	+ 2.6	– 2.6
Food	82.1	82.1	+ 1.9	– 8.8
Industrials				
All	98.8	99.4	+ 2.5	+ 4.4
Nfa†	82.8	83.2	+ 1.8	–10.8
Metals	112.4	113.1	+ 2.9	+16.9
Sterling index				
All items	74.7	75.5	+ 5.1	– 4.0
Euro index				
All items	88.2	89.8	+ 3.6	– 5.3
Yen index				
All items	99.0	99.2	+ 0.9	– 4.8
Gold				
$ per oz	425.93	421.85	– 3.4	– 0.7
West Texas Intermediate				
$ per barrel	42.17	45.78	+ 9.5	+33.2

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jan 13th 2005
From The Economist print edition

Market indices

		2004-05		% change on one week	% change on record high	Dec 31st 2003 in local currency	Dec 31st 2003 in $ terms
	Jan 12th	high	low				
Australia (All Ordinaries)	4,068.3	4,071.7	3,274.9	+ 0.6	– 0.1	+23.1	+25.5
Austria (ATX)	2,421.6	2,475.1	1,568.9	– 1.0	– 2.2	+56.7	+65.1
Belgium (Bel 20)	2,973.9	3,002.7	2,244.2	+ 0.1	–19.2	+32.5	+39.6
Britain (FTSE 100)	4,783.6	4,854.1	4,287.0	– 0.5	–31.0	+ 6.9	+13.0
Canada (Toronto Composite)	9,022.7	9,287.4	8,123.5	nil	–20.8	+ 9.8	+18.6
Denmark (KBX)	258.3	261.7	219.0	+ 0.1	–14.4	+21.0	+27.5
France (SBF 250)	2,633.6	2,672.1	2,386.1	– 0.1	–40.0	+ 9.2	+15.0
(CAC 40)	3,816.1	3,878.0	3,465.3	– 0.3	–44.9	+ 7.3	+13.0
Germany (DAX)	4,208.8	4,316.4	3,647.0	– 1.2	–47.8	+ 6.1	+11.8
Italy (BCI)	1,475.2	1,492.0	1,239.5	– 0.5	–32.4	+17.4	+23.7
Japan (Nikkei 225)	11,453.4	12,163.9	10,365.4	+ 0.1	–70.6	+ 7.3	+12.3
(Topix)	1,147.9	1,217.9	1,022.6	+ 0.4	–60.2	+10.0	+15.1
Netherlands (AEX)	350.1	364.8	310.7	nil	–50.1	+ 3.7	+ 9.2
Spain (Madrid SE)	950.9	965.4	804.4	– 0.5	–17.0	+17.7	+24.0
Sweden (Affarsvarlden Gen)	219.9	225.8	188.5	– 1.1	–45.1	+16.8	+23.3
Switzerland (Swiss Market)	5,669.6	5,934.4	5,309.7	– 1.0	–32.6	+ 3.3	+ 9.8
United States (DJIA)	10,617.8	10,854.5	9,750.0	+ 0.2	– 9.4	+ 1.6	+ 1.6
(S&P 500)	1,187.7	1,213.6	1,063.2	+ 0.3	–22.2	+ 6.8	+ 6.8
(NASDAQ Comp)	2,092.5	2,178.3	1,752.5	+ 0.1	–58.6	+ 4.5	+ 4.5
Europe (FTSE Eurotop 300)*	1,038.6	1,056.5	940.9	– 0.5	–39.1	+ 8.4	+14.2
Euro area (FTSE Ebloc 100)*	894.4	910.3	787.2	– 0.7	–42.3	+ 7.5	+13.3
World (MSCI)†	1,145.9	1,170.0	997.0	+ 0.3	–20.9	+10.6	+10.6
World bond market (Citigroup)‡	661.7	666.7	575.1	+ 0.8	– 0.7	+ 9.6	+ 9.6

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jan 13th 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 Jan 12th	year ago	Currency units per $ Jan 12th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 18.0	Nov	− 36.2	Q3	− 6.0	− 5.4	86.2	89.7	1.30	1.29	2.46	1.73	1.27	+ 0.7
Austria	− 0.1	Oct	− 1.6	Oct	− 0.6	− 0.7	103.4§	102.8	0.75	0.79	1.42	–	0.74	− 1.5
Belgium	+ 20.7	Oct	+ 11.7	Sep	+ 3.6	+ 3.4	104.0§	102.9	0.75	0.79	1.42	–	0.74	− 0.1
Britain	−104.0	Nov	− 47.4	Q3	− 2.4	− 2.6	101.8	102.8	0.53	0.54	–	0.70	0.52	− 3.2
Canada	+ 52.8	Nov	+ 26.7	Q3	+ 2.8	+ 2.2	95.2	88.9	1.20	1.29	2.26	1.59	1.17	+ 1.1
Denmark	+ 9.5	Oct	+ 6.2	Oct	+ 2.9	+ 2.6	107.3	107.1	5.60	5.87	10.6	7.44	5.47	+ 0.9
France	− 6.0	Nov	− 3.1	Oct	+ 0.1	+ 0.1	107.6§	106.3	0.75	0.79	1.42	–	0.74	− 3.7
Germany	+192.7	Nov	+ 95.9	Nov	+ 3.1	+ 2.9	105.4§	103.9	0.75	0.79	1.42	–	0.74	− 3.9
Italy	+ 0.1	Oct	− 11.8	Oct	− 0.8	− 0.9	76.7§	75.8	0.75	0.79	1.42	–	0.74	− 2.9
Japan	+135.8	Oct	+167.7	Nov	+ 3.3	+ 3.4	138.6	136.7	102	106	194	136	–	− 6.5
Netherlands	+ 35.6	Oct	+ 21.0	Q3	+ 3.0	+ 3.0	103.6§	102.3	0.75	0.79	1.42	–	0.74	− 2.9
Spain	− 70.5	Oct	− 41.3	Sep	− 3.7	− 3.9	77.8§	77.0	0.75	0.79	1.42	–	0.74	− 1.1
Sweden	+ 22.5	Nov	+ 26.2	Q3	+ 7.6	+ 6.7	83.2	81.6	6.81	7.24	12.9	9.05	6.65	+ 0.5
Switzerland	+ 8.1	Nov	+ 44.7	Q3	+12.4	+11.9	113.6	111.8	1.16	1.23	2.20	1.55	1.14	− 1.6
United States	−653.8	Nov	−603.2	Q3	− 5.5	− 5.6	89.3	93.8	–	–	1.89	1.33	0.98	− 4.4
Euro area	+ 94.7	Oct	+ 47.3	Oct	+ 0.5	+ 0.5	93.9	92.4	0.75	0.79	1.42	–	0.74	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.3	Oct	+ 6.1	Oct	na	na	92.7§	81.6	0.75	0.79	1.42	–	0.74	+ 2.3
Greece	− 30.3	Oct	− 10.3	Oct	na	na	60.0§	59.4	0.75	0.79	1.42	–	0.74	− 5.3
Iceland	− 0.8	Nov	− 0.6	Q3	na	na	96.1**	93.0	62.6	69.8	118	83.2	61.1	+ 0.1
Ireland	+ 41.5	Oct	− 1.6	Q3	na	na	96.3§	94.5	0.75	0.79	1.42	–	0.74	+ 0.2
Luxembourg	− 4.4	Oct	+ 2.1	Q2	na	na	104.0§	102.9	0.75	0.79	1.42	–	0.74	− 0.4
New Zealand	− 2.8	Nov	− 5.3	Q3	na	na	106.8	105.3	1.41	1.47	2.67	1.87	1.38	+ 2.9
Norway	+ 33.6	Nov	+ 33.2	Oct	na	na	99.2	95.0	6.17	6.73	11.7	8.20	6.03	+ 8.2
Portugal	− 17.9	Oct	− 12.0	Oct	na	na	93.7**	93.2	0.75	0.79	1.42	–	0.74	− 2.9

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, November average. ‡OECD estimate.
**IMF, September average.

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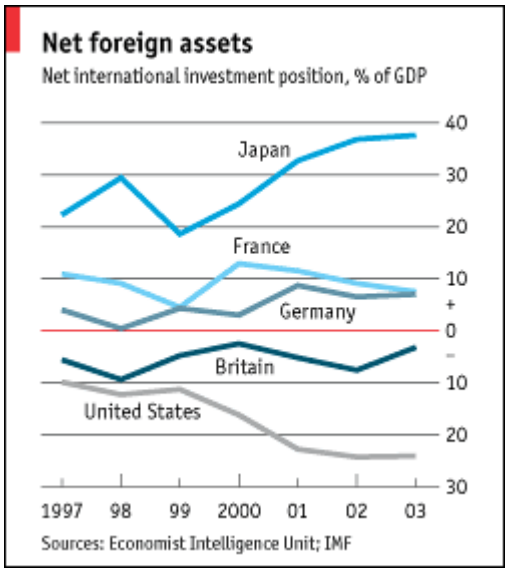
Net foreign assets

Jan 13th 2005
From The Economist print edition

Japan's stock of net foreign assets rose to 38% of GDP by the end of 2003. In contrast, America's net foreign liabilities hit 24% of its GDP. Britain is also a net foreign debtor.



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Overview

Jan 13th 2005
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China ran a trade surplus in 2004 of $31.9 billion, the highest since 1998.

Industrial-production growth in **India** slowed to 7.9% in the 12 months to November. In **Malaysia** it picked up to 9.9% over the same period.

Industrial output rose by 8.1% in **Brazil** in the year to November. In **Mexico**, it increased by 5.4% over the same period.

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Central-bank staff

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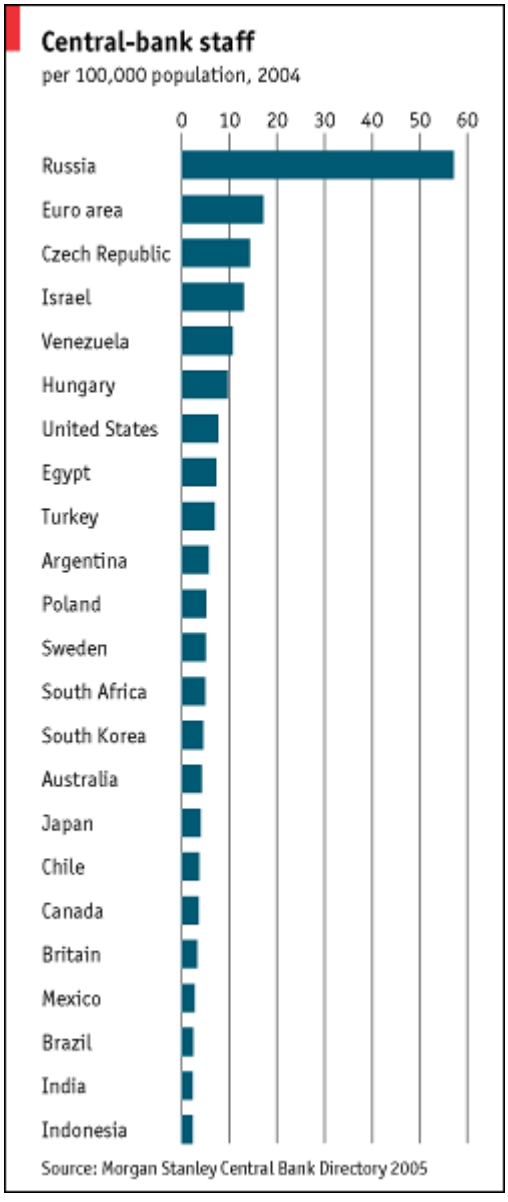
Russia has the highest concentration of central bankers in any large economy, with almost 60 central bankers per 100,000 people. Including its regional branches, Russia's central bank has a staff of over 80,000. The euro area is also awash with central bankers: over 52,000, or 17 per 100,000 population. Although the number of central bankers has fallen by 7% since the single currency's launch in 1999, the euro system still has more than twice as many employees as America's Federal Reserve, which oversees monetary policy for a larger economy.



Economy

Jan 13th 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.1	Q3	+14.8	Nov	+ 2.8	Nov	+31.9	Dec	+45.9	2003	514.5	Sep
Hong Kong	+ 7.2	Q3	+ 3.4	Q3	+ 0.2	Nov	–12.4	Nov	+14.2	Q3	123.6	Dec
India	+ 6.6	Q3	+ 7.9	Nov	+ 4.2	Nov	–21.3	Nov	+ 3.5	Q3	125.2	Dec
Indonesia	+ 5.0	Q3	– 2.3	Aug	+ 6.4	Dec	+24.3	Nov	+ 4.0	Q3	34.6	Nov
Malaysia	+ 6.8	Q3	+ 9.9	Nov	+ 2.2	Nov	+21.2	Nov	+14.7	Q3	62.2	Nov
Philippines	+ 6.3	Q3	+ 9.0	Oct	+ 7.9	Dec	– 1.3	Oct	+ 4.4	Sep	12.9	Dec
Singapore	+ 5.4	Q4	+13.2	Nov	+ 1.7	Nov	+15.1	Nov	+29.0	Q3	110.1	Nov
South Korea	+ 4.6	Q3	+10.1	Nov	+ 3.0	Dec	+29.8	Dec	+27.5	Nov	192.5	Nov
Taiwan	+ 5.3	Q3	+ 5.4	Nov	+ 1.6	Dec	+ 6.1	Dec	+24.8	Q3	241.7	Dec
Thailand	+ 6.0	Q3	+ 9.5	Nov	+ 2.9	Dec	+ 1.3	Nov	+ 7.0	Nov	47.1	Nov
Argentina	+ 8.3	Q3	+ 5.4	Nov	+ 6.1	Dec	+12.2	Nov	+ 3.6	Q3	19.6	Dec
Brazil	+ 6.1	Q3	+ 8.1	Nov	+ 7.2	Nov	+33.7	Dec	+10.7	Nov	50.1	Nov
Chile	+ 6.8	Q3	+ 9.9	Nov	+ 2.4	Dec	+ 8.2	Nov	+ 2.0	Q3	16.0	Nov
Colombia	+ 2.4	Q3	+ 1.4	Oct	+ 5.5	Dec	+ 0.9	Oct	– 1.4	Q3	12.8	Nov
Mexico	+ 4.4	Q3	+ 5.4	Nov	+ 5.4	Nov	– 7.0	Nov	– 5.5	Q3	60.9	Oct
Peru	+ 2.1	Oct	+ 6.1	Oct	+ 3.5	Dec	+ 2.5	Nov	– 0.3	Q3	11.5	Nov
Venezuela	+15.8	Q3	+14.7	Oct	+19.2	Dec	+21.5	Q3	+14.4	Q3	16.4	Sep
Egypt	+ 4.3	2004†	+ 3.3	2004†	+11.9	Sep	– 8.1	Q3	+ 4.1	Q3	13.5	Sep
Israel	+ 3.4	Q3	+ 8.2	Oct	+ 0.9	Nov	– 6.8	Dec	+ 0.5	Q3	27.0	Dec
South Africa	+ 3.8	Q3	+ 2.3	Nov	+ 3.7	Nov	– 1.5	Nov	– 4.7	Q3	13.2	Dec
Turkey	+ 4.5	Q3	+ 9.6	Nov	+ 9.3	Dec	–34.2	Nov	–15.7	Nov	35.3	Nov
Czech Republic	+ 3.6	Q3	+10.9	Nov	+ 2.8	Dec	– 1.2	Nov	– 6.4	Q3	28.5	Dec
Hungary	+ 3.7	Q3	+ 7.7	Nov	+ 5.8	Nov	– 2.5	Q3	– 8.6	Q3	15.2	Nov
Poland	+ 4.8	Q3	+11.3	Nov	+ 4.5	Nov	– 5.6	Oct	– 4.3	Oct	35.8	Nov
Russia	+ 6.4	Q3	+ 6.0	Nov	+11.7	Dec	+84.6	Nov	+49.5	Q3	113.7	Nov
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 6.1	Q3	+ 6.3	Oct	+ 5.0	Dec	– 2.5	Sep	– 1.5	Q2	1.5	Oct
Latvia	+ 9.1	Q3	– 0.8	Oct	+ 7.3	Dec	– 2.6	Oct	– 1.6	Oct	1.8	Oct
Lithuania	+ 5.8	Q3	na		+ 2.9	Dec	– 3.2	Nov	– 1.8	Q2	3.4	Oct
Slovakia	+ 5.3	Q3	+ 2.5	Nov	+ 6.3	Nov	– 1.2	Nov	– 1.0	Aug	13.0	Oct
Slovenia	+ 4.9	Q3	+ 3.8	Nov	+ 3.6	Nov	– 1.0	Oct	– 0.8	Oct	8.0	Sep
Pakistan	+ 6.4	2004†	+18.6	Jul	+ 7.4	Dec	– 5.3	Nov	+ 0.8	Q3	9.8	Nov
Saudi Arabia	+ 7.2	2003	na		+ 0.4	Oct	+59.1	2003	+28.0	2003	23.6	Nov

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡Year ending June, new series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Financial markets

Jan 13th 2005
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jan 12th		Dec 31st 2003	
	Jan 12th	year ago	Jan 12th	% a year		one week	in local currency	in $ terms
China	8.28	8.28	15.7	3.80	1,319.5	+0.4	– 15.9	– 15.9
Hong Kong	7.79	7.76	14.8	0.79	13,565.3	– 1.4	+ 7.9	+ 7.4
India	43.6	45.4	82.5	5.39	6,102.7	– 5.5	+ 4.5	+ 9.4
Indonesia	9,195	8,343	17,403	7.56	1,008.6	– 0.7	+ 45.8	+ 33.5
Malaysia	3.80	3.80	7.19	2.82	933.3	+2.8	+ 17.6	+ 17.6
Philippines	55.9	55.5	105.9	7.63	1,820.6	– 2.9	+ 26.2	+ 25.3
Singapore	1.63	1.70	3.09	1.75	2,079.8	+0.4	+ 17.9	+ 22.7
South Korea	1,043	1,180	1,973	3.45	880.0	– 0.6	+ 8.6	+ 24.1
Taiwan	31.9	33.6	60.4	1.35	5,879.1	– 1.8	– 0.2	+ 6.2
Thailand	38.9	39.0	73.5	2.40	694.6	+1.6	– 10.0	– 8.3
Argentina	2.95	2.87	5.59	4.88	1,344.1	+3.0	+ 25.4	+ 24.5
Brazil	2.69	2.82	5.10	17.74	24,509.0	– 0.7	+ 10.2	+ 18.1
Chile	565	574	1,070	2.76	8,620.3	– 2.3	+ 17.5	+ 23.2
Colombia	2,353	2,745	4,454	7.73	4,347.9	+1.4	+ 86.3	+120.1
Mexico	11.2	10.8	21.1	8.59	12,329.2	– 2.1	+ 40.2	+ 41.0
Peru	3.27	3.46	6.18	2.94	3,826.3	+2.4	+ 57.1	+ 66.7
Venezuela	2,829§	2,934§	5,354	12.59	29,922.7	– 0.2	+ 34.8	+ 35.8
Egypt	5.92	6.16	11.20	9.90	25,858.1	+1.6	+122.2	+131.5
Israel	4.35	4.42	8.24	1.00	652.6	+3.7	+ 22.1	+ 23.3
South Africa	5.95	7.11	11.3	7.60	12,724.8	+0.4	+ 22.5	+ 37.4
Turkey	1.35**	1.35	2.55	19.80	26,271.3	+7.6	+ 41.1	+ 47.5
Czech Republic	22.9	25.7	43.3	2.56	1,066.6	– 0.6	+ 61.8	+ 81.7
Hungary	186	210	352	9.19	15,053.6	+1.9	+ 60.5	+ 79.1
Poland	3.06	3.74	5.79	6.65	25,716.8	– 1.3	+ 23.5	+ 51.1
Russia	27.8	28.9	52.7	13.00	605.5‡	– 1.4	+ 1.6	+ 6.7
EMF (MSCI)*	1.00	1.00	1.89	na	522.3	– 0.6	+ 17.9	+ 17.9
EMBI+†	1.00	1.00	1.89	na	327.8	+0.5	+ 11.2	+ 11.2

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate. **New lira.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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